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REACHING FOR RECOVERY:

New Economic Initiative in Michigan

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Summary

Michigan is among the states hardest hit by recessions and economic change. Faced with the enormous task of rebuilding a stable base with limited public resources, the state has moved boldly to bring about economic revival. State officials and private-sector leaders have devised special initiatives to build on existing economic advantages, respond to special opportunities, and promote new industries with growth potential.

This report describes these efforts, highlighting several new approaches and traditional incentives that Michigan has adopted well. They include:

- a targeted industry development program that joins public-sector efforts and resources with private investments;
- state-sponsored "centers for excellence" to speed technological innovation and adaptation in crucial industries;
- a sophisticated, state-managed venture capital program using state pension funds;
- the combination of several elements to improve the state's business climate; and
- a framework with which local jurisdictions and organizations can create cohesive employment and economic development programs.

The targeted industry development program stimulates desired growth patterns by earmarking state resources for selected industries with potential. Three industries were identified: forest products, food processing, and auto suppliers.

Through its centers for excellence, Michigan is making direct investments in public-private-academic programs to promote the development of new technologies and subsequent private commercial applications.

Michigan's venture capital program, with the largest state-managed fund in the country, channels much-needed investment dollars into growing companies.

Using state pensions funds, Michigan serves as a direct institutional investor and has put over $40 million in its own portfolio of companies. It also has committed or invested more than $78 million as a limited partner in other funds. Program officials identify responsible venture capital investments that can help support the state's revitalization strategy. The program has gained an important degree of acceptance within the national venture capital industry.

The improvement in Michigan's business climate is particularly notable. Michigan's reputation as a terrible state in which to do business is beginning to change. It has established a computerized business ombudsman service and eliminated nearly one-third of the required state forms and documents necessary to do business. Strangling securities registration requirements were lifted in favor of a "rational merit" approach, which relies on traditional market forces to provide investor protection. The state also has set up business incubation centers, reformed the franchise laws, and overhauled the workers' compensation insurance program. Few jurisdictions ever have implemented so comprehensive a package. The cumulative effect of these improvements, which have gained business and consumer support, makes this initiative workable.

Finally, Michigan is the site of several combined training and economic development projects. The Downriver Community Conference has received national acclaim for its approach to linking traditional job-training services with development and job-generating activities, such as business loan packaging, procurement assistance, and related services. The Ford Foundation has made a $2-million loan to a group of three such organizations, permitting them to become a limited partner in a private venture capital pool. This project intends to revive the local economy by tieing the job-creating possibilities of new companies with the job-training and development capacities of the three-member group.

In short, Michigan has identified its economic strengths and structured its development efforts to build on this base. The state has assumed the needed role of catalyst for and investor in its economic future.

Preface

Michigan is one of the states hardest hit by recessions and economic change. Facing the enormous task of rebuilding with limited public resources, its officials have thought creatively and acted wisely to promote economic revitalization. This report, undertaken with the support of the Charles Stewart Mott Foundation, is a case study of Michigan's recent efforts to find new opportunities and develop new techniques to spur economic growth.

This report does not attempt to explore every state-assisted incentive program to stimulate business development; like most states, Michigan offers a full range of programs addressing a variety of needs. It does not attempt to assess the state's place in the national or world economy or set forth a long-term economic strategy; The Path to Prosperity, a recent analysis directed by Doug Ross, now director of the Michigan Department of Commerce, fulfills that purpose well. Rather, this report highlights several economic development initiatives in which Michigan has excelled -- both new approaches and traditional incentives that Michigan has adapted successfully.

This analysis of Michigan's efforts is intended to help other state and local governments as they inventory their own strengths and revamp their economic development strategies. Governments must develop a plan and manage it boldly if they wish to spur economic recovery, diversification, and growth within their borders. As the U.S. economy continues its transition, sustained growth increasingly will become reliant on innovation, the introduction new technology into traditional industries, and development of new enterprises. Government must be ready to serve as a catalyst for change and to provide a receptive business and entrepreneurial climate. Michigan has adopted a number of programs and policies that have helped its industries adapt to change and build for the future. These examples can be instructive for other jurisdictions.

The author would like to thank the Charles Stewart Mott Foundation for its generous support and the many persons who agreed to be interviewed for this analysis. Their knowledge and observations on Michigan economic development were essential to its preparation. William Lukens, director of the Michigan High Technology Task Force, and Peter Eckstein, executive director of the Governor's Commission on Jobs and Economic Development, provided detailed and constructive comments that were much appreciated. In addition, Northeast-Midwest Institute research associate Colin Zick assisted with the formidable

bibliographic task, and editor Debby Cooney aided in organizing its diverse ideas and improving the readability of the text. Their help was invaluable in overcoming the many logistical and technical hurdles that inevitably appear while undertaking a project of this size and scope.

I. Economic Development in Perspective

The U.S. economic engine emerged from the most recent recession in far different shape than it did from the previous downturn. Signs -- first acknowledged in the 1970s -- that changes were occurring in the foundations of the nation's business, employment, and technology became increasingly pronounced. The downturn that began in 1980 became an economic shakeout.

Although there is evidence of an underlying dynamism in the manufacturing sector, an economic staple in the Northeast and Midwest, many of the oldest and largest companies have languished since that time. Some have cut employment, shifted operations to newer plants in different (often foreign) locations, or simply folded altogether. Restructuring this damaged economic base has required a coordinated effort on the part of government, business, universities, and labor. New companies and industries had to be generated, capital sources uncovered, and new jobs created. Viable older firms needed revitalization as well, so they could adapt and grow.

Across the country, state and local governments have begun to grapple with this transition by exploring ways to assist the diversification and modernization of their economic bases. Shifting economic horizons bring uncertainty to the formulation of solutions. As a result, the shaping and implementation of economic development strategies have received much public attention recently. Many officials and practitioners have come to realize that micro-strategies can have an impact, at least at the margin.

In order to evaluate a state's economic performance and new development initiatives, several interrelated factors must be put into perspective. The successful adjustment from one set of economic activities to another constitutes "economic development." It occurs when investment, new or expanded businesses, new technologies, and new jobs are introduced into an area.

Direct and indirect public assistance can encourage this process. Public and private sectors may undertake joint development projects -- customized job training, industrial expansion, downtown development, and historic preservation, for example. These seemingly diverse activities are linked by a common thread, however. They are components in a strategy to attract private investment and maintain or create the jobs necessary to cope with economic change and its problems. Dealing with a transformed economy is the most critical issue facing many communities in Michigan and other states. It requires adjustment

from an existing, often outmoded, economic base to a new, productive one with the financial, physical, and organizational ability to sustain growth.

For economic development efforts -- whether a single neighborhood project or an entire city or state strategy -- to succeed, the environment must be supportive of business investment. The components of this environment include:

- o a suitably trained and affordable work force;
- o business space or land suitable for development at a reasonable price;
- o appropriate infrastructure and other supportive services;
- o adequate and affordable capital for a variety of needs;
- o a tax climate conducive to investment; and
- o social, educational, and governmental capacity to assist development.

Areas in economic decline are lacking one or more of these elements. Furthermore, the economic development process is a fluid one; the optimal balance of these various public and private factors can change as the overall economic climate evolves.

In a recent report, the President's Commission on Industrial Competitiveness emphasized that "states should be a key catalyst in bringing together technology, manpower, capital, and management necessary for stimulating entrepreneurship and innovation."[1] In the face of declining federal development resources and shifting service-delivery responsibilities, states are, in fact, developing and applying the most exciting and innovative programs and strategies. In Michigan, they include:

- o targeting three industries for a special development effort using state and private investments;
- o launching centers for excellence to promote change and innovation in particular industries and technologies;
- o instituting state-managed venture capital programs using state pension funds;
- o combining disparate elements to improve the state's business climate; and
- o providing the framework for combining job training and economic development.

Each of these efforts is described in detail in the following chapters.

II. Economic Baseline

To assess Michigan's recent economic development initiatives realistically, this report used a significant starting point against which their impact could be compared. The 1981-1982 period was chosen as the baseline for three reasons:

- The election of a president who espoused a diminished federal role in the economy has had a marked effect on several federal economic development programs since 1981. Although the president's proposed "new federalism" legislation has not passed Congress, the premise of greater state responsibility for development activities has been incorporated in the Job Training Partnership Act, social services block grants, and the state-administered small-cities Community Development Block Grant program. A number of development functions also have passed to the states and cities either directly or because of reduced federal interest.

- Federal budget priorities have shifted away from economic development activities since 1981. The purchasing power of federal resources has continued to shrink and programs have been pared back. States increasingly are forced to commit funds for economic development purposes if previous levels of activity are to be continued.

- The economy, at the national level and in Michigan, reached a turning point during this period. The recession -- which was most severe in 1981-1982 -- drove home the reality that the manufacturing sector, the foundation of Michigan's economy, had lost its competitive edge and was in dire need of modernization and diversification.

The following discussion reviews the state's business climate during this time period and highlights key indicators of the Michigan economy. Important state and local business-incentive and assistance programs also are described.

Michigan's Economy in 1981-1982

Michigan was in the grip of a severe recession during 1981-1982. Its slowdown began late in 1979, well before the economic pinch was felt nationally. The slump was even deeper than that of 1974-1975, then considered the worst in Michigan since the great depression of the 1930s.

Even in the midst of a deep recession, however, Michigan's historical concentration of manufacturers was its economic mainstay. The picture of universal gloom pervading all industries painted by many commentators simply was inaccurate. There was an underlying dynamism even in troubled industries. Michigan's labor force continued to be among the nation's most productive, ranking third among industrial states.[2] The state's Single Business Tax (SBT) encouraged capital investment, and financial incentives were in place to assist new and expanding companies. Over 175 industrial development corporations and 300 economic development corporations throughout Michigan provided the vehicles for state and local cooperation in economic development endeavors.[3] Table 1 provides some basic economic and demographic data for the baseline period. The shape of the economy is shown in several key indicators, examined below.

Work Force

The 1980 census lists Michigan's population at 9.3 million people. Approximately 38 percent of the state's residents were age 19 or under and 34 percent were ages 20 to 44, making its work force relatively young.[4] The U.S. Department of Labor reported in October 1981 that Michigan had:

- 4.4 million persons in the civilian labor force;
- 3.9 million people working: almost 75 percent in nonmanufacturing occupations (with 500,000 in retail sales alone) and 25 percent in manufacturing (with 500,000 in direct or supplier auto industry companies); and
- 512,000 persons unemployed.[5]

The state's unemployment rate then was 13.8 percent. The problem became even worse as the slump continued, with the rate reaching 17.3 by December 1982 during the recession's depth.

While nonmanufacturing jobs outnumbered manufacturing jobs by a three-to-one margin, nearly 1 million Michigan residents earned their living at manufacturing concerns -- one of the highest concentrations in the nation. Figure 1 illustrates Michigan's employment by sector in 1982.

During this period unemployment in Michigan continued to rise, with the manufacturing sector losing a considerable number of jobs. In fact, job dissipation in the auto industry accounted for nearly half of all manufacturing job decline, exceeding the 40.9 percent reduction of the 1974-1975 recession.[6]

Although workers in nonmanufacturing occupations were less affected by the recession, some sectors had significant job losses. Often, these businesses were auto suppliers and, in turn, their clients. For example, construction firms dropped 15.5 percent and distributive industries 3.6 percent of their work forces.[7] In contrast, employment in both the service and government sectors grew slightly during this period.

TABLE 1

Michigan Baseline Data: 1980-1982

	Michigan Total	Percent of U.S. Total
Population		
1980	9,255,000	4.1
1981	9,215,000	4.0
1982	9,109,000	3.9
Nonagricultural employment		
1980	3,443,000	3.8
1981	3,364,000	3.7
1982	3,189,000	3.6
Production workers' average hourly wages		
1980	$ 9.52	130.9
1981	$ 10.53	131.8
1982	$ 11.18	131.5
Per capita personal income		
1980	$ 9,872	103.9
1981	$ 10,620	100.4
1982	$ 10,956	98.6
Industrial and commercial failures		
1980	604	5.1
1981	867	5.2
1982	not available	not available
Value of construction contracts		
1980	$ 4,174,000,000	2.8
1981	$ 3,258,000,000	2.1
1982	$ 2,488,000,000	1.6
New privately owned housing units authorized		
1980	29,000	2.4
1981	19,000	1.9
1982	14,000	1.4
Agricultural acreage harvested		
1980	7,346,000	2.1
1981	7,362,000	2.1
1982	7,079,000	2.1
Total net farm income		
1980	$ 507,000,000	1.9
1981	$ 395,000,000	1.8
1982	$ 421,000,000	1.8

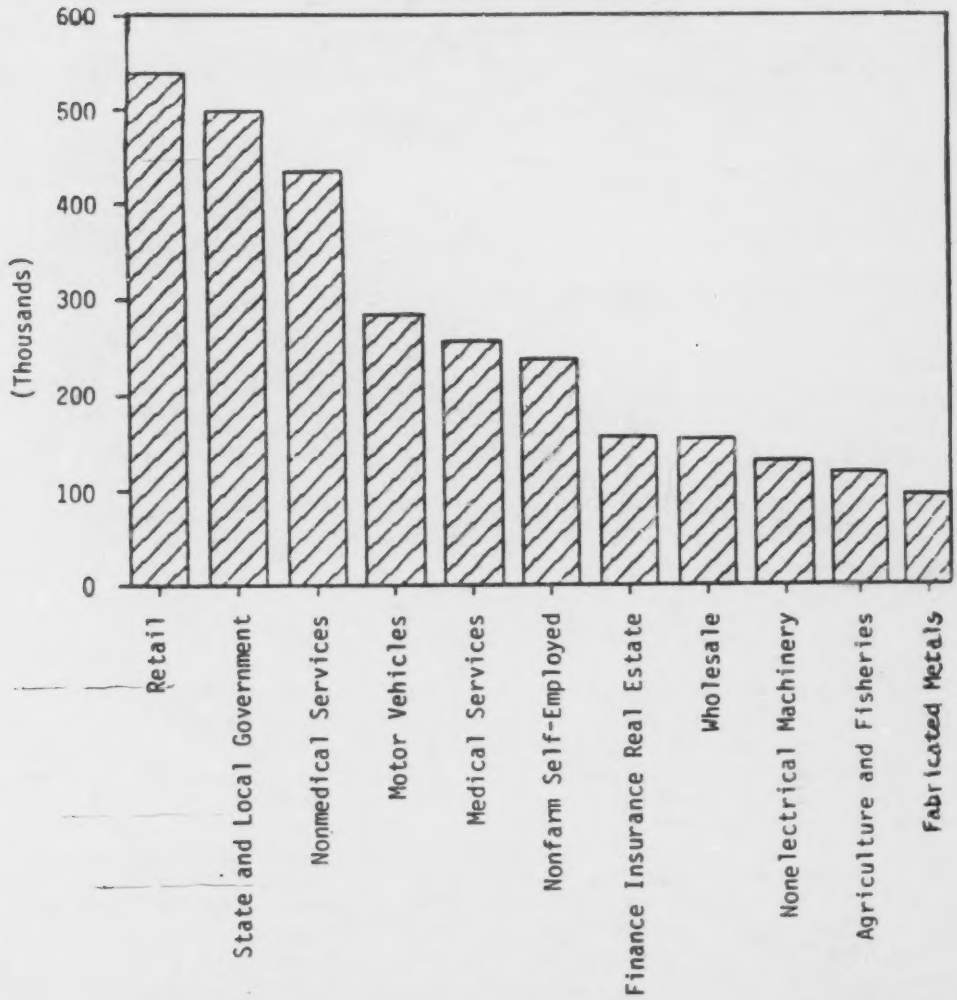
TABLE 1 (continued)

Labor force characteristics, 1982		
Number of persons employed	4,276,000	3.9
Number of persons unemployed (160% of national rate)	661,000	6.2
Employment security, 1982		
Insured claimants	473,000	3.4
Beneficiaries	604,000	2.4
Exhaustions	250,000	6.0
Initial claims	1,785,000	5.9
Benefits paid	$ 1,524,401,000	7.5
Nonagricultural employment by sector, 1982		
Wholesale and retail trade	689,000	3.4
Services	653,000	3.4
Manufacturing	874,000	4.6
State and local government	579,000	3.7
Finance, insurance, real estate	152,000	2.8
Transportation, public utilities	142,000	2.8
Construction	90,000	2.3
State and local government actual expenditures, 1981		
Education	$ 6,926,000	4.8
Highways	$ 1,165,000	3.4
Public welfare	$ 2,827,000	5.4
Health, hospitals	$ 1,658,000	4.6
All other	$ 5,600,000	4.1
Total expenditure	$18,176,000	4.5
State and local government expenditures per capita, 1981		
Education	$ 748	116.1
Highways	$ 126	82.4
Public welfare	$ 305	132.0
Health, hospitals	$ 179	112.6
All other	$ 604	100.2
Total expenditure	$1,962	109.6
Banks, 1982		
Number	374	2.6
Assets	$ 56,621,000,000	3.0
Savings and loans, 1981		
Number	59	1.4
Assets	$ 18,718,000,000	2.8

SOURCE: Staff calculations from Statistical Abstract of the United States: 1984 (Washington, D.C.: U.S. Government Printing Office, 1983), passim, and The World Almanac and Book of Facts 1984 (New York, N.Y.: Newspaper Enterprise Assn., 1983), passim.

FIGURE 1

MICHIGAN'S LARGEST SECTORS, 1982
(Thousands of Jobs)



SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce, cited in Doug Ross, et al., The Path to Prosperity (Lansing, Michigan: Task Force for a Long-Term Economic Strategy for Michigan, 1984), p. 5.

Personal Income

Even with wide economic fluctuations, Michigan traditionally has enjoyed a higher per capita income level than the national average because a large portion of its work force was employed in high-wage, durable goods industries. As Table 2 indicates, growth of per capita income in Michigan from 1975 to 1980 exceeded the national average.

TABLE 2

Michigan Per Capita Income and Growth Rate, 1970-1980

Year	Michigan	U.S.
Per Capita Personal Income (in dollars)		
1970	$4,041	$3,893
1975	6,008	5,861
1980	9,847	9,458
Average Annual Growth Rate (in percent)		
1970-80	9.3	9.3
1970-75	8.3	8.5
1975-80	10.4	10.0

SOURCE: Harvey E. Brazer, ed., Michigan's Fiscal and Economic Structure (Ann Arbor, The University of Michigan Press, 1982), p. 73.

Taxes

Michigan state revenues are derived from a variety of tax sources. The largest business levy is the Single Business Tax (SBT), adopted in 1975. A modified value-added tax, the SBT is levied at 2.35 percent of total compensation, net income, depreciation, and interest paid (minus credits and exemptions). Unlike the corporate income taxes in all other states, the SBT is based on the level of economic activity rather than solely on corporate profits. A 4 percent sales or use tax is levied on all retail sales or rentals. A personal income tax of 4.6 percent was in effect during the baseline period. Property taxes are levied by local governments, all of which are required to assess properties at 50 percent of true market value.[8] Table 3 provides highlights of Michigan's major tax sources during this period.

Property taxes are the single largest source of government and school-district revenue, amounting to 42.5 percent of total state and local taxes in 1982.[9] (The U.S. average that year was 30.8 percent.) In 1983, local taxes yielded $5.19 billion in revenue to local goverments, an increase of only 0.3 percent over the previous year and the smallest since 1940. Reflecting the decline in consumption caused by the recession, SBT revenues grew only 3 percent from 1980 to 1981, then stagnated. Sales tax revenues also remained flat. Only personal income tax revenues rose significantly, increasing by 9 percent.

TABLE 3

Michigan Tax Revenues: Specific Levies
(in millions of dollars)

Tax	1980	1981	1982
Single Business Tax	$917.0	$942.2	$943.1
Personal Income Tax	1,727.6	1,788.2	1,970.3
General Sales/Use Tax	1,738.3	1,736.3	n/a
Ad valorem Local Property Taxes	4,411.7	4,898.4	5,172.5

SOURCES: Michigan Department of Treasury, Taxation and Economic Policy Office, Analysis of Michigan Individual Income Tax (Lansing, Michigan: April 1984), p. 1; and Property Taxes in Michigan (Lansing, Michigan: May 1984), p. 3.

State-Directed Economic Development Initiatives

When the adverse economic currents hit with full force in 1981, Governor Milliken delivered a special message to the legislature outlining a state economic revitalization strategy. This proposal concentrated on two development themes:

- o reducing the cost of doing business in Michigan by cutting workers' compensation and unemployment insurance costs for employers, increasing Single Business Tax (SBT) income and capital-investment exemptions, and easing business and environmental regulations; and
- o promoting the creation of new businesses, especially high-technology ventures, through new economic development loan funds, additional small business assistance centers, and urban enterprise zones.[10]

Reformation of workers' compensation was a top priority in the first set of proposals. The administration and state trade groups considered the existing system the greatest obstacle to business investment and job development. On December 30, 1981, the governor signed a package of 12 bills modifying the compensation statute.[11] These changes were followed by further reform of the insurance code, which reduced workers' compensation rates by 20 percent and instituted open competition in that insurance market. The second set of development issues brought legislation authorizing new programs to increase the availability of capital for business development. Public pension funds were granted permission to place up to 5 percent of their assets in venture capital investments. In addition, a new Michigan Economic Development Authority (MEDA) was created within the Department of Commerce to provide financing for industrial projects. MEDA was to be supported in part by state oil and gas royalties.

Governor Milliken also established several task forces to explore various facets of the state's economy and recommend actions to promote its diversification and recovery. Prominent among these were a public-private high technology task force and a regulatory review panel to examine state laws, policies, and rules inhibiting economic development and private investment.[12] Early in his term, Governor Blanchard refocused and expanded several features of this strategy and incorporated both general themes into his own economic development agenda.

Business Climate, 1982

Two major independent surveys of the Michigan business climate were published in 1982. These types of reports usually compare one area with another using a set of measurable criteria. Such state-by-state comparisons can be misleading because many of the factors are hard to measure or are not comparable from place to place. Some seemingly negative factors may have positive sides that are not reflected in the findings. For example, higher taxes and fees often support better education systems and increased public amenities. Survey results should be interpreted with caution, because factor selection often reflects the interests or biases of the sponsoring organizations. Nevertheless, they can provide a useful snapshot of perceived public and private economic development conditions at a specific time and can convey the business tenor of the state.

The Fantus Company conducted one such survey to review changes in Michigan's business environment over the past decade and suggest steps for further improvements. The Fantus survey identified 32 factors that companies use to assess the business climate in a given area. Fifteen of these factors relate to operating costs (such as taxes and utility rates) and the remainder evaluate operating conditions (such as training and the availability of financing).

Fantus evaluated Michigan for all of these factors, rating the results positive, negative, or neutral; it then compiled a list of advantages and disadvantages in starting or expanding a business in the state.

- Eleven factors garnered <u>favorable</u> ratings in a majority of the Michigan communities examined and were viewed as advantages: sewer service charges; level of inventory taxes; availability of financing; presence of appropriately trained work force; transportation services; community cooperation; water service availabilty; labor force stability; natural gas service; and electric power service.

- Eight factors received predominantly <u>unfavorable</u> ratings and were regarded as disadvantages or disincentives to business growth: hourly wages; fringe benefits; electricity rates; natural gas rates; workers' compensation; state business taxes; unemployment insurance; and labor-management relations.

- Thirteen factors were viewed as having neither a strongly positive nor negative impact on Michigan's business climate. These <u>neutral</u> factors were: local property taxes; transportation charges; site costs; construction costs; water service rates; site availability; quality of

life; labor quality and productivity; sewer service availability; industrial support services; municipal services; vocational and technical training; and availability of professional or managerial staff.[13]

Fantus noted that the state's business climate was considerably better in 1982 than in 1972. It attributed this improvement to state actions that diminished costs for starting up and doing business, especially expanded business assistance programs, and tax code changes. Its report stressed the need for Michigan to maintain that momentum and continue to attract new businesses. The report made several recommendations, such as establishing a high-technology research park and streamlining and otherwise improving permit and regulatory procedures, especially in the Department of Natural Resources. Fantus also suggested expanding local economic development programs. Many of the state's recent business growth and development initiatives have incorporated facets of these 1982 suggestions.

The second study was Alexander Grant and Company's periodic assessment of national corporate climate. Structured from a traditional business vantage point, it ranked Michigan very poorly. The company's procedure is to evaluate each state on 22 government-controlled and independent-business factors ranging from labor costs to environmental controls. Michigan's composite rank in 1982 was 48, the lowest among the Great Lakes states.[14]

State and Local Economic Development Tools

Michigan communities have a wide variety of mechanisms available for incorporation into a local economic revitalization or growth strategy. The most important, all of which were approved by the legislature within the last decade, are described below.

- Nonprofit Economic Development Corporations (EDCs) were authorized in 1974. Created by local government action, EDCs are empowered by the state to issue tax-exempt bonds, finance property and equipment, and acquire and develop property.

- Downtown Development Authorities (DDAs) also were authorized in 1974 and empowered to implement development plans by acquiring and disposing of property, levying taxes, and issuing bonds.

- Tax Increment Finance Authorities (TIFAs) were created in 1980 to provide a redevelopment finance tool for Michigan cities; TIFAs can issue both revenue and tax increment bonds needed to finance public improvements associated with local redevelopment programs.

- The Plant Rehabilitation and Industrial Development Districts Act of 1974 provides significant property tax incentives to encourage renovation and expansion of existing plants as well as new construction.

- Commercial Redevelopment Districts were authorized in 1978; they offer tax benefits to commercial businesses similar to those available in plant rehabilitation districts.

- The Michigan Economic Development Authority (MEDA) was established in 1982 to offer a wide range of technical and financial support for communities and private industry through programs such as its Industrial Facility Conversion Loan Fund and Research Center Fund.

As the following "Michigan menu" shows, the state offered numerous other incentive and financial assistance programs similar to those in many other states during the baseline period.

These programs can be used to assist project financing, train workers, reduce tax burdens, upgrade infrastructure -- most of the ingredients necessary for economic development to occur. Michigan has as comprehensive a set of development tools as any other state.

TABLE 4

Economic Assistance Programs

State Program	Available In Michigan	Number of States Available
Small Business Assistance		
Small business office	Yes	35
Loan program	Yes	25
Procurement program	Yes	25
Government liaison	Yes	13
Advisory board	Yes	20
Financial and Technical Assistance Programs for Business		
Tax increment financing	Yes	27
Pollution control financing	Yes	43
Targeting plants to distressed areas	Yes	22
Plant expansion financing	Yes	33
Building loan guarantees	Yes	19
Building loans	Yes	25
Equipment/machinery loans	Yes	21
State agency for IDB financing	Yes	28
Private development credit corp.	No	33
Industrial development authority	Yes	32
Procurement assistance	Yes	34
Incentives for training the structurally unemployed	Yes	35
State job training program	Yes	49
State R&D facilities	Yes	47
R&D promotion program	Yes	40
Planning funds	Yes	37
Public works funds	Yes	39
State incentives for locating plants in distressed areas	Yes	19
State-owned industrial parks	No	10
State Tax Incentives for Business		
Uniform property tax evaluation	Yes	43
Accelerated depreciation on equipment	Yes	33
Tax exemption for R&D expenditures	Yes	15
Credit for industrial investment	Yes	21
Tax incentives for job creation	Yes	18
Tax exemption on raw materials	Yes	48
Sales/use tax exemption	Yes	38
Tax exemption or moratorium on capital improvements	Yes	30
Excise tax exemption	No	16
Personal income tax exemption	Yes	20
Corporate income tax exemption	Yes	23
Umbrella bond financing	Yes	22

SOURCE: Northeast-Midwest Institute, The 1983 Guide to Government Resources for Economic Development (Washington, D.C., 1983), pp. 121-127.

III. Recognizing and Maximizing Existing Economic Advantages

A jurisdiction's competitive advantage is, quite simply, what it does better than others and what assets it has. State and local leaders must recognize and promote this advantage, even if it is conventional and somewhat invisible on the national scene. In recent years, many communities have become enamoured with the latest glamour industries and earmarked considerable resources to encourage their development, only to discover that they could not assemble the competitive "critical mass" necessary for success.

Before describing Michigan's new initiatives, it is necessary to outline those related changes in administrative structure and program focus that have supported the state's development strategy and made these initiatives possible. Michigan officials have recognized and made progress toward maximizing the state's existing economic advantages. This was done on several fronts at once. This discussion will describe three key elements of this effort: The Targeted Industry Development Program; changes in the state's administrative structure; and a new economic development agenda.

The present administration made an important early decision to build on Michigan's existing economic foundation. Facing serious budget constraints and with limited resources available for economic development efforts, the state simply would not be able to assist all businesses. Governor Blanchard directed his Cabinet Council on Jobs and Economic Development (described later in the chapter) to devise special initiatives to address the economic needs ". . . of industries in which Michigan has an historic competitive advantage: industries which comprise a major portion of our economic base and are important to the development, expansion, and diversification of that base."[15]

In spite of the wear and tear of the last recession, Michigan's competitive strength continues to lie in durable goods manufacturing. This sector is described vividly in The Path to Prosperity, a recent analysis of Michigan's prospects for long-term economic prosperity directed by Doug Ross, now director of the Department of Commerce.

> [T]he state remains one of the leading centers of durable goods manufacturing in the world. We possess some of the largest manufacturing firms in the world in a variety of industries, including automobiles, steel, machinery, office equipment, chemicals, pharmaceuticals, appliances, and office furniture. Our management and labor skills are concentrated in manufacturing to a degree

perhaps greater than any other state in the nation. We have a vast industrial infrastructure, highways, railroads, airports, water and related resources, physical plant, equipment, labor--created expressly to support manufacturing. We have a broad network of suppliers and ancillary industries already in place to serve our manufacturing economy. Our universities are strong in industrial technology. Michigan's fundamental problem is that we no longer employ these resources in the most competitive and innovative way to produce the most competitive products.[16]

Michigan's future, the report argues, lies in its ability to regain prominence as a leader in manufacturing technology. Governor Blanchard's original economic development agenda was based in part on this assumption. That plan focused on:

- retaining and strengthening existing businesses while encouraging the growth of entrepreneurial firms;
- helping the state's businesses and workers adapt to the changing technological realities of the next 15 years; and
- combining public resources with private investments in modernizing companies and sectors that will become growth factors in the state's future.[17]

State officials have begun to implement this agenda, and have made some progress in achieving its objectives. Much of this success is due to the analytic thoroughness that policy makers brought to the planning process. Existing programs were reevaluated and modified if necessary; a framework for the new agenda was put in place. Because of this comprehensive planning, the overall effort has a solid foundation.

Targeted Industries

After an initial assessment of Michigan's economic situation, which was built on earlier efforts along these lines, state officials established a Targeted Industry Development Program (TIDP) in mid-1983. Its purpose was to "identify and then exploit" the state's economic strengths on a sectoral basis.[18] TIDP is based on the premise that "state government can act more effectively to stimulate desired economic growth by targeting its resources on a limited number of industries holding special potential for growth and creation of permanent new jobs."[19] Three industries were identified by the end of 1983: forest products, food processing, and auto suppliers.

The Cabinet Council pursued this approach because it met the special needs, problems, and opportunities of selected industries in a comprehensive way and built on an existing base in manufacturing. The TIDP is coordinated at the cabinet level and has the strong and visible support of the governor -- crucial factors for a program that cuts across department and agency lines. Clearly, this type of targeting effort would not work without the active support of top officials

and a manageable bureaucratic structure. Under the TIDP arrangement, one state department serves as the lead agency for each of the three designated industries; this agency, in turn, conveys the instructions of the Cabinet Council and oversees the interagency activities needed to implement specific action programs.

In the case of forest products, for example, the Department of Natural Resources (DNR) is the lead agency. Because of the entrepreneurial assistance tools under its jurisdiction, the Department of Commerce (DOC) works closely with DNR in business development activities; in fact, the two agencies have formed a joint forest industry team that markets Michigan's forest products and resources to outside concerns. The Transportation Department also is involved in the forest industry development program. Periodically, DNR convenes an interagency coordinating meeting attended by high-ranking officials to address industry problems and issues. Responsibilities for future agency actions are determined at these sessions. As with most "interturf" bodies, the work ultimately is parcelled among individual department staff. What makes the TIDP noteworthy is its lower and mid-level staff coordination; with the encouragement of agency heads, staff members have formed their own working groups with their counterparts in sister TIDP agencies.[20]

This spirit of cooperation has resulted in important accomplishments even though the TIDP initiative has been in place for only a short time. The staff prepared an analysis for each industry outlining obstacles to sectoral growth as well as opportunities for expansion. Cabinet Council and agency staff also have suggested state actions to maximize the benefits that firms in each industry can deliver to Michigan. The program has its critics. Some business leaders have criticized this approach as unfairly favoring certain industries by placing them in a more favorable light. Others see the TIDP is a thinly disguised program to institute a state industrial policy. However, there are no specific TIDP funding resources, development incentives, or set-asides in existing programs.

The addition of program staff in the agencies with the capability to coordinate and package existing incentives for projects in target industries has made the program work. These specialists were recruited to build professional credibility with companies and to serve as advocates and contacts in their agencies -- an activist approach not often found in government.[21] Target industries are the focus of development efforts; they benefit from higher staffing levels, increased staff responsiveness, and data dissemination. This effort has great promise for continued future accomplishments. Highlights of each TIDP follow.

Forestry

The forest industry, already important to Michigan, has significant growth potential because of recent advances in biotechnology. Noteworthy research is underway at several state universities, which made forestry particularly attractive for TIDP designation. With current forest growth nearly three times the rate of harvest, the state's forest industry offers major opportunities for new development and expanded employment. Michigan's commercial forest acreage is fifth largest in the nation.[22]

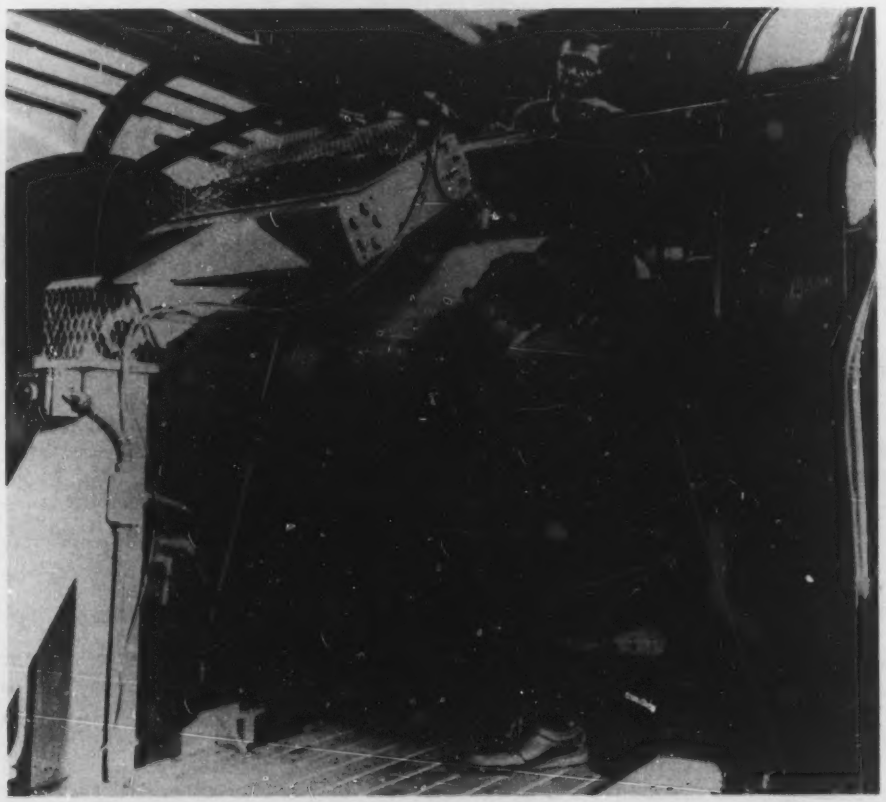
As mentioned earlier, DNR is the lead agency for the forest industry. Through TIDP, the state has brokered forest industry links with:

- the four state universities with programs in forest management and industries;
- the Michigan Biotechnology Institute (MBI), a nonprofit corporation which promotes the commercialization of research developments and findings;
- the state's new computerized Michigan Product Information Exchange (MIPIE); and
- out-of-state and foreign markets.

In addition, a newly created State Forest Products Industry Development Council, made up of government and forest industry leaders, is expected to advise on and promote industry expansion. The council met for the first time on January 9, 1985.

FIGURE 2

Michigan Forest Resources



New technology can expand the economic potential of one of Michigan's chief natural resources.

SOURCE: U.S. Department of Agriculture

In pursuing this type of coordinated state policy, officials anticipate an array of secondary manufacturing activities, such as furniture stock and plywood, as well as primary forestry industries. Initial efforts have been directed at small and medium-sized firms to stimulate expansion and product diversification. A technologically advanced sawmill installed at one site will enable that company to use Michigan red pine instead of imported yellow pine. The programs have helped another company to gear up for production of a new wood product -- a "loggette" that can be used as fuel for wood stoves or grills.

According to preliminary estimates, about $102 million in new private money was invested in state-assisted forest industry projects in 1984. These investments created 600 new jobs directly and an estimated 1,800 to 3,000 more in support industries such as logging.[23]

Food Processing

Designation of food processing as a target industry reflected the state's agricultural diversity and strength and acknowledged the "potential for enhancing the value of Michigan's many commercial food crops before shipping them out of state."[24] Improvements in both packaging and in the food products themselves could bring new jobs and business investment to the state. Close coordination between the Department of Agriculture, the lead agency, and the

FIGURE 3

Michigan's Food Processing Industry

The food processing industry is one of Michigan's target growth industries.

SOURCE: National Food Processors

Department of Commerce resulted in a more effective channeling of DOC resources and programs to food-processing businesses and entrepreneurs. An important factor in this coordination was DOC's hiring of a food-processing expert in 1984 to serve as agency contact for the TIDP.

A major program goal will be achieved when Michigan State University establishes a Food Industry Institute on campus. Planned for 1985, this Institute will provide the structure through which food processors, for a fee, will be able to tap into available research facilities. The service will be especially valuable to small firms with no research or problem-solving capability of their own.[25]

Since 1983, state-assisted projects have generated nearly 2,000 jobs and $90 million in new private investments in Michigan's food processing industry.[26] One of the most prominent has been an effort to advance the development of paperboard cartons for single-serving juice and fruit drinks. Other activities include research to perfect a soynut alternative to peanut butter. This project has received considerable attention by both agriculture and development officials; while soybeans are one of Michigan's most important cash crops, nearly all of the harvest is shipped out of state for processing. Plans are underway to ready the new product for commercial production and develop suitable packaging.[27]

Auto Suppliers

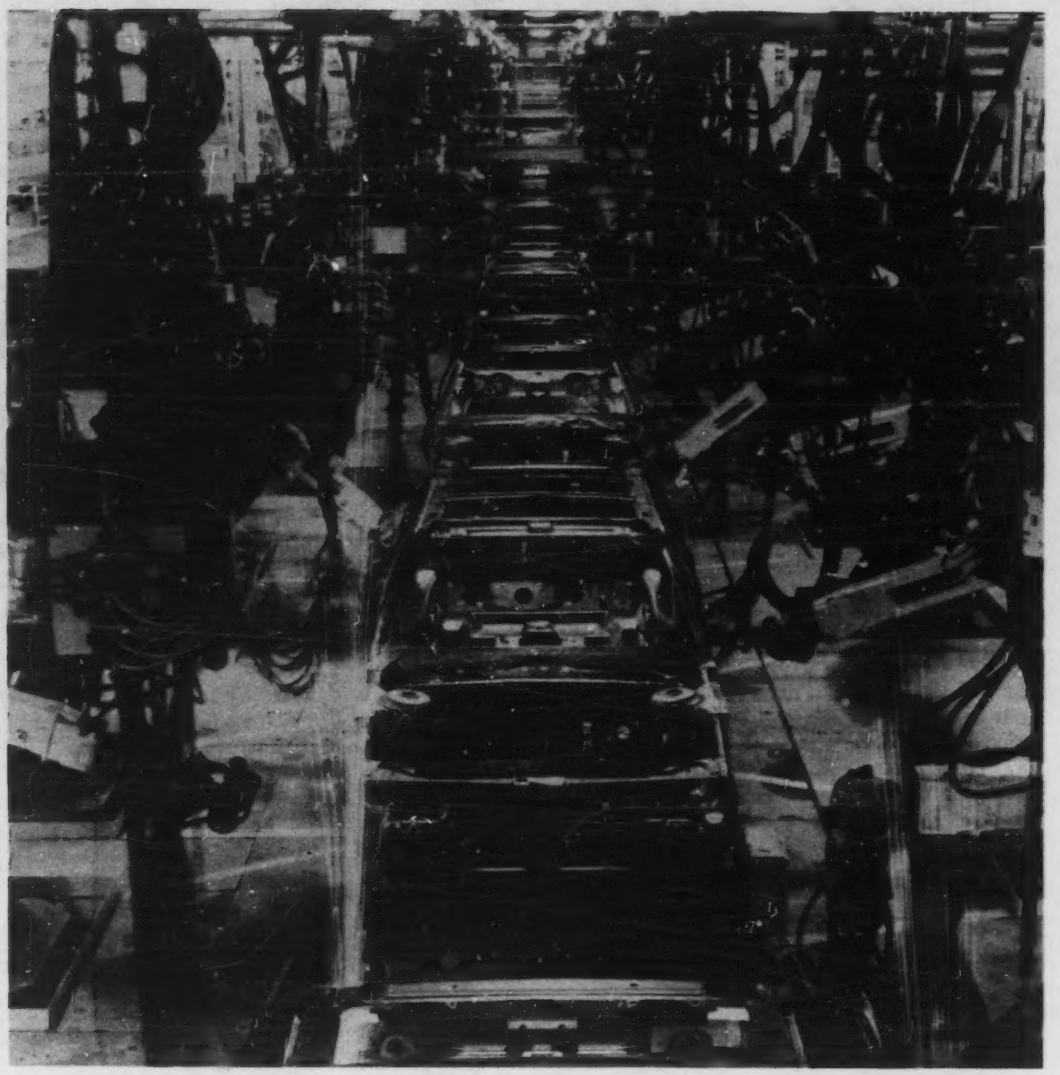
Unlike forestry and food processing, the auto supplier industry does not represent a major growth sector for Michigan; however, it was chosen for the targeted industry program because its modernization and renewed competitiveness is viewed as vital for the state's future. As recounted in the Cabinet Council analysis, the diversification represented by the food processing and forest industries will be important, but it "is essential that the state examine steps it can take to assure the continued viability of the on-going heart of Michigan's present, past, and future economy", namely, the auto industry.[28]

The changing nature of the auto supplier industry was a determining factor in the state's designation. These businesses were thought to have accommodated to the pronounced business cycles of the Michigan economy; they always had rebounded after each downturn. However, this confidence was shaken after the most recent recession, and state officials were convinced that the industry was changing in ways that would place new stress on an already depressed industry. In an effort to improve product quality, the Big Three automakers were making technological demands which smaller suppliers could not meet. To reduce their own costs, the financially strapped automakers also were shifting research and development costs to auto industry suppliers.[29]

The auto supplier TIDP has two objectives: to bring about the adoption of technological changes necessary for the industry to regain its market, and to educate suppliers about the development tools available to help them make that transition. State efforts have focused on cultivating ties between supplier industries and high-technology advances in materials, electronics, and mechanical components. The founding of the Industrial Technology Institute was an important complementary effort. One of ITI's top priorities is to conduct research and promote development of advanced industrial automation and to encourage the adoption of sophisticated manufacturing technologies -- the so-called "factory of the future" -- that will enhance the state's industrial competitiveness.[30] (ITI is described in detail in Chapter IV.)

FIGURE 4

Auto Supplier Industry



The "factory of the future" is becoming a reality today through technological innovations developed in Michigan.

SOURCE: Chrysler Corporation

At the direction of the Cabinet Council, the state has directed other activities at the auto industry suppliers TIDP effort. These include:

- offering job-training assistance for supplier companies;
- developing a computerized data base of auto supplier industries, products, and customers; and
- providing targeted federal-procurement help to expand client bases.

The state is exploring further assistance to this industry, including more targeted business and worker incentives.

Changes in Administrative Structure

Two new entities recently were introduced into the state's administrative structure to make government more responsive to business and economic development needs, to stretch public resources, and to coordinate service delivery more efficiently.

Cabinet Council

Recognizing the need for the state to maximize economic development efforts through high-level coordination, Governor Blanchard established a Cabinet Council on Jobs and Economic Development in one of his earliest executive orders. Somewhat similar to a development task force of the previous administration, the Cabinet Council brings together the directors of the nine state departments primarily involved in economic development programs and issues. These officials meet on a monthly basis, and frequently the governor participates. They have set up numerous interagency staff working groups and made many contacts that have strengthened the concept. So far, the council has been a good organizing and coordinating vehicle for several state initiatives.

To encourage business, labor, and local development leaders to contribute ideas to this effort, the governor also established a Commission on Jobs and Economic Development as a private-sector counterpart of the Cabinet Council. These two groups worked together at the beginning of Blanchard's term and helped to create the governor's 20-point agenda for economic development, which was presented to the legislature in October 1983.[31]

The Cabinet Council has met many of its original objectives. In a number of cases, it has enhanced coordination at lower staff levels and commensurately increased the state's capacity to deliver business services.[32]

Community Growth Alliances

Community Growth Alliances (CGAs) are regional coalitions of public and private-sector representatives with an interest in economic development activities. Their governing boards, which include business owners, elected officials, development company managers, and labor leaders, cut across jurisdictional and public-private lines.

The CGA program was inaugurated in 1984, and by early 1985 some 13 had been designated. Individual CGAs are authorized by the governor, based on

applications to the Office of Business Development within DOC; 11 designation requests are currently pending.[33] To the extent possible, they are based on existing, natural economic development "boundaries," such as labor markets or business-service areas. These structures were created to:

- help organize the state's hundreds of local economic development groups into natural "alliances" to help them recognize and take advantage of their common interests;
- help the state deliver its economic development resources in a more efficient manner and avoid duplicate investments in neighboring areas; and
- speed the gathering and dissemination of information on state economic development activities.[34]

Upon designation, each CGA is entitled to as much as $200,000 in start-up funding for three main components:

- a Small Business Center (up to $75,000), which encourages new business formation and provides management and other technical assistance;
- an Area Development Office (up to $50,000), which provides site selection, financial packaging, business retention, and related services; and
- a local Procurement Office (up to $75,000), which helps businesses obtain federal procurement contracts.[35]

In addition, Michigan Bell Telephone Company will provide $5,000 worth of computers for as many as 20 CGAs, linking them to one another, the DOC, state offices, and other information sources. Michigan Bell's commitment will enhance this type of local coordination, which rarely has succeeded when tried in other places.

At this time, the state does not intend to provide much more than start-up funding for these centers, gradually phasing out its financial support within two or three years. It is too soon to determine whether this will happen -- or even if the CGAs themselves will succeed. Initial criticisms were leveled against their central planning characteristics. Some local officials view them as an unnecessary and confusing additional layer in the state economic development process. Yet there is potential for meaningful coordination with tangible benefits; already some CGAs are preparing regional industrial attraction strategies that pool common benefits into a coordinated package to meet more economic development needs.

The Michigan Economic Development Agenda

Soon after taking office in 1983, Governor Blanchard outlined a 20-point economic development agenda devised in conjunction with the Cabinet Council and Governor's Commission. Some items were designed to build upon and enhance the state's existing economic advantages and strengthen targeted industries. They included:

- o reducing the cost of unemployment insurance and workers' compensation;
- o establishing a Governor's Office for Job Training;
- o forming a computerized Michigan technology-transfer network;
- o reforming securities registration and franchise procedures;
- o securing a greater share of federal procurement contracts; and
- o expanding SBT relief for small business.[36]

These elements have been the focus of state efforts for the past two years. Sometimes working together and sometimes independently, the legislature, governor, and state agencies have tallied a number of achievements. For example, Michigan has moved into the forefront nationally with practical applications of computer technology to help state agencies assist businesses. The targeted industries and centers for excellence hold great promise for bringing new investment and new jobs to the state. State officials continue to explore new ways to improve the business climate by building on previous efforts as well as instituting new policies.

In short, Michigan has begun an economic recovery, and state officials have launched a number of programs and initiatives to enhance it. Admittedly, many of these efforts would not succeed if a national economic recovery were not underway; the state's fortunes will continue to be linked inextricably with national conditions. A well-known saying on the condition of the state's economy is that when the national economy sneezes, Michigan catches pneumonia. If these new efforts can be institutionalized successfully, however, perhaps in the future Michigan will catch only a cold. The following chapters will describe in detail four of Michigan's especially noteworthy economic development initiatives.

IV. Centers for Excellence

Technological modernization has been one of the most important factors in rekindling economic growth in Michigan. State leaders recognized that a successful high technology economic development strategy needed public-sector intervention and some degree of direction at two stages: initial efforts to stimulate research on new technologies and subsequent efforts to promote their commercial application. What distinguished Michigan from many places, though, was its understanding that high technology itself was not an industry waiting to be uncovered but a process leading to industrial innovation that needed to be applied "somewhere and to something."[37]

In the past few years, new state programs have been launched and existing ones reoriented to foster this dual strategy. These activities encouraged the integration of new technologies into the existing economic base. The most promising of these are the "centers for excellence," which feature an unusual level of university-public-private sector cooperation. The centers -- most notably the Industrial Technology Institute (ITI) and the Molecular Biology Institute (MBI) -- were founded in late 1981 and formally launched the following year.

Evolution of the Centers

A blue-ribbon High Technology Task Force was created in 1981 to identify industries offering the greatest potential for technological innovation and to map a way to proceed. The centers concept received its first specific public reference in a July 1981 task force report, "A World Class Research and Development Center for Michigan."[38] The impetus was the concern that Michigan businesses were losing their prominence and competitiveness in the national and world economy.[39]

The task force scrutinized Michigan's economy thoroughly to identify the bright spots beneath the gloom of the decline, and to pinpoint areas where a concentration of resources would yield positive results. The agreed-upon goal of these centers was to help diversify the state's industrial economy and create new jobs. The task force had a diverse but strong membership that included some of the state's most prominent business, government, foundation, and academic leaders such as the governor, William Hubbard of the Upjohn Corporation, Ted Doan of the Doan Resources Corporation, and University of

Michigan President Harold Shapiro. Their efforts were pivotal in attracting subsequent participation from representatives of the Kellogg and Upjohn Foundations. Task force members provided ties to an extensive network of high-level public and private-sector organizations throughout the state and took the lead in generating business and philanthropic support for the centers for excellence. Their collaboration was a key element in the eventual success of this initiative.[40]

The task force's strongest recommendation was that the state promote technology transfer by participating directly in the research-to-commercialization process. Like many states, Michigan recognized that it must act as a catalyst in the development process by using state-sponsored institutions to forge necessary business-university research links. At the task force's urging, though, Michigan crafted an atypical blueprint. It chose to concentrate state assistance in a limited number of visible sites and industries. These few programs then would be used to attract enough private investment and top-notch talent to have a significant multiplier effect. The centers concept represents an important advance in the evolution of public-private partnerships.

The task force analysis suggested that each center develop specialized resources for advanced applied research on a single growth-oriented industry. It concluded that "a broad attack on technical industries will not succeed" because resources were limited and other states would offer stiff competition in many sectors. The task force emphasized that "concentration and selectivity are essential" if state efforts and resources were to be effective and influential.[41]

The centers for excellence were structured around core services and amenities. Each was expected to serve as a focal point for regional economic growth and job creation by providing opportunities for business and university collaboration in laboratory research that would exceed any single entity's capability, and by encouraging clusters of new businesses related to their specialty, especially in product marketing and delivery.

The task force evaluated potential industries for such a concentration and narrowed the field of prospects. It assessed ways in which selected industries could complement Michigan's existing economic base, build on its comparative economic advantage, tap the strengths of state universities, and attract private and federal research and development resources. After considerable deliberation, the task force recommended two diverse industries, discussed in depth below, on which to focus state efforts.

- Advanced industrial automation. Michigan had the necessary industrial infrastructure in place to court this type of technological research. Major expansion in this industry appeared imminent and there were no dominant industrial or academic centers elsewhere.

- Molecular biology. The bright future for commercial applications, combined with Michigan's substantial food and forestry industries, made this field too important to ignore. Nationwide, the commercial development of this new industry was in its infancy. Yet, the task force felt that Michigan could assemble the necessary public and private resources to have a strong hand in defining this emerging field.[42]

The state created the Industrial Technology Institute to encourage further work in industrial automation and the Molecular Biology Institute (later renamed the Michigan Biotechnology Institute, MBI) to spearhead research efforts in molecular biology. It also established the Metropolitan Center for High Technology (MCHT), a conventional small business incubator located near downtown Detroit, to provide a site for emerging high technology companies in both of those fields.

The task force rejected several other center concepts in spite of their potential. For instance, it decided against a semiconductor project because many other states have firmly rooted programs and Michigan lacks many of the necessary labor and industrial base elements. It eliminated medical electronics because the focus was too narrow to justify a large commitment of state resources.[43]

Center Support

These centers are supported by both public and private resources. In 1982, the legislature authorized a $25-million state research and development fund for the three centers: $17 million to ITI; $6.5 million to MBI; and $1.5 million to MCHT. Funding the centers from a state oil and gas royalty program proved controversial; some legislators argued vehemently that these revenues were never intended for economic development. Those that prevailed felt that this designation of funds sent an important signal to state business and foundation executives. In fact, this demonstration of state support for the centers concept convinced several Michigan foundations to make commitments. The Kellogg Foundation has contributed $40 million to ITI and $10 million to MBI, and the Dow Foundation has provided ITI with $10 million.[44] Some of these commitments are conditional on performance; others require matches, which will bring in additional resources.

The funding mechanism for the centers operates in two stages. Each center seeks state, federal, and foundation assistance for early research work -- usually the hardest part of a project to fund. Later projects are to be financed by contracts with the industry that particular center intends to serve. This approach permits centers to conduct initial work with relevance to industrial problems, thus building the necessary credibility to attract private dollars.

Michigan's leading universities provide an important source of in-kind support. Michigan State University and the University of Michigan have contributed land and facilities and shared professional and technical staff. Wayne State University has provided technical assistance. The centers, however, emphasize that they are university <u>connected</u> and not university <u>based</u>. After some deliberation, the task force recommended this loose association. Several task force members believed that some companies would shy away from supporting "academic" centers. In their view, free-standing structures outside a university setting would provide the best vehicles to enhance business access and promote spin-offs while keeping the centers "industrially relevant."[45]

Industrial Technology Institute

The Industrial Technology Institute specializes in the development of automated manufacturing and robotics techniques and equipment. It also promotes their adoption by Michigan manufacturers to give them an edge over the competition. ITI's computer-based factories are designed to adjust more readily to fluctuations in market demand and changes in designs, materials, and tooling. The automated factory itself is an emerging industry with estimated annual sales potential of $25 billion by 1990.

The health and even survival of smaller manufacturing firms throughout the nation will be decided, in large part, by their success in incorporating new automated technologies into production processes. Some upgrading of industrial plants will probably occur after each downturn to maintain the competitiveness of durable goods industries, which continue to provide Michigan's economic foundation. ITI hopes to provide the expertise to help industries remain competitive and ease the transition to more complex manufacturing methods that require the specialized employee skills Michigan already has. This will help ease the declining prospects of the blue-collar work force.

The University Relationship

Institute officials finally decided to locate their facilities next to the University of Michigan campus in Ann Arbor to take advantage of its existing strengths.[46] The university is one of the nation's best in industrial, mechanical, and electrical engineering and is rapidly becoming a world leader in the industrial application of computer technology.

ITI's physical location was more easily decided than the nature of the center-university relationship. If it had been made a formal part of the university system, the Institute would have had easier access to its faculty and been in a stronger position to bid for federal research money. However, ITI was set up as a free-standing institution because of fears for its independence.[47] Some believed that establishing ITI within the University of Michigan might have undermined its image as a technology problem-solver capable of operating successfully in a competitive, private-sector environment. Potential business clients were concerned that such a relationship would undermine ITI's "industrial application" research thrust and might discourage other industrial sponsors and service users. ITI is striving to create an independent identity. However, it benefits from its relationship with the university, which provided administrative services and low-cost space that reduced the center's costs during its start-up phase.

ITI has proposed that the university set up part-time center appointments as a faculty-attraction strategy. The university has not yet accepted the offer, even though affiliation with the research institute might attract prospective faculty. University policy also discourages departments from extending part-time or adjunct appointments to ITI staff. Some university officials see ITI as a competitor for talent, foundation resources, and federal research grants rather than a potential partner. Institute staff are confident that most of these differences of opinion can be resolved over time, however, and anticipate that opportunities to strengthen the relationship will increase.

Resources and Staff

The Institute's first funding came in 1982 from the Michigan Economic Development Agency, which earmarked $17.5 million over six years -- a significant sum to commit to a new endeavor during a time of financial crisis. The funds were used to recruit staff and undertake basic projects. The MEDA support indicated a high level of state backing and expectations for ITI at a critical juncture. About this time several Michigan foundations also decided to devote resources to projects that could help Michigan build for the future. ITI was a top candidate for such investments.

The Institute has an ambitious capitalization goal -- $200 million over the next ten years.[48] Some critics feel that this figure represents an unnecessarily high target and is misleading when program needs are examined. Others fear that ITI's capitalization efforts will drain resources from other research entities. Most state officials agree, however, that this level reflects the financial reality of building a top research and development enterprise. They believe that a high level of support is essential to attract the staff expertise that ITI needs to gain and maintain prominence in the field of industrial automation. Its goal is financial self-sufficiency, although no time frame has been established.[49]

Staff development is still in its early stages. Dr. Jerome A. Smith was selected as ITI president in 1982 after a nationwide search. By early 1985, approximately 80 staff were in place, including a small technical staff and all division heads. Smith projected an increase to 137 employees during 1985. The eventual goal is 250 permanent staff, although Smith believes that ITI could become self-sustaining with considerably less.[50]

Operational Plans

When fully operational, ITI's research activities will run on three tracks, each with its own sources and levels of support. The first track consists of short-term development projects featuring ideas or procedures that can be implemented in one to three years. Half of ITI's current efforts are devoted to such projects. Eventually they will be funded almost entirely by private industry on a contractual basis. Additional revenues will be derived from the royalties, licenses, and fees that these research results generate. ITI recently entered into its first such sponsored-research project.

Another 25 percent of ITI's endeavors will be in applied research, namely, projects exploring potential commercial applications of basic research results that might be achieved within two to five years. These projects, such as feasibility demonstrations and first-stage diagnostic tools and prototypes, would be funded by a combination of private industrial and government sponsors. The final 25 percent would be research aimed at improving basic knowledge in the robotics field. State and federal agencies, such as the National Science Foundation, are the most likely sources for needed funding in this area.

The Institute's initial projects have come in the first track -- short-term projects. Current programs, which are just getting under way, focus on six broad areas:

- Developing state-of-the-art manufacturing automation for existing applications and newly emerging areas. ITI also is working with

manufacturing companies to help them adapt commercially available automated-manufacturing technologies.

- Helping manufacturing companies with various economic and business analyses of the effects of automation.

- Running technical assistance programs to solve problems associated with integrating hardware and software into large, coordinated systems. These programs help businesses develop flexible production systems that are technically feasible and economically practical.

- Developing hardware and software components such as robot sensors and computer-vision devices. These undertakings are beyond the fiscal means of most companies.

- Testing and teaching the new management and efficiency methods that the factory of the future will require.

- Promoting and participating in studies of the social aspects of a changed manufacturing milieu, including effects on job contents, worker attitudes, and new training needs.[51]

The last area is one of ITI's most important, according to Jerome Smith. Most private companies are equipped with neither staff nor resources to undertake this type of self-assessment or provide necessary guidance to managers and employees coping with new technologies and the implications of automation.[52]

The Foundation Role

As mentioned, major Michigan philanthropic foundations are playing an important role in the evolution of ITI. They were actively involved in the high-technology task force and continue to provide financial backing to the fledgling center.

Officials of the Herbert and Grace Dow Foundation recognized the importance of institutions such as ITI in promoting economic development within the state; the foundation contributed $10 million to the effort. The W.K. Kellogg Foundation's involvement shows how a foundation can link its resources to other economic development efforts in a viable partnership. Established in 1930 as a "practically" rooted community-assistance foundation, its economic development projects often have focused on Michigan.

In the early 1980s, the foundation reevaluated its program and mission, deciding to reassert its original principle of "application of existing knowledge to the problems of people." This self-scrutiny coincided with the severe recession. Feeling a need to play an active role in reversing this decline, the Kellogg Foundation invested in projects with direct economic impact. The foundation chose to invest more in a type of project it had always supported -- development projects linked to educational endeavors. The recently formed ITI was a prime candidate. Its promise of technology-generated employment opportunities that required educated and trained workers fit the foundation's goals.[53] The center for excellence concept also addressed the foundation's concern that the scholarly excellence of Michigan's educational institutions was eroding.

The high degree of government, university, and business involvement in ITI has been key to the Kellogg Foundation's support; its backing, in turn, has strengthened these initial relationships.[54] Foundation representatives were impressed by this mutual support while participating on the high technology task force. In particular, they were encouraged that the centers for excellence concept weathered strong political turbulence, which gave weight to their worth as viable economic tools with bipartisan political support.

Judging ITI's Progress

The Institute is still too new to be subjected to a full-scale evaluation of its effectiveness. By 1985, much of the necessary start-up capital had been raised and a few larger corporate sponsors had been attracted. For example, General Motors has contributed $1 million of the estimated $16.8 million necessary for construction of the permanent ITI facility, begun in early 1985. ITI is well on its way to achieving its initial objectives.

It will be more difficult for ITI to move into its next phase. The center must develop the framework and mechanisms to deliver direct assistance to small and mid-sized companies that need help to modernize their manufacturing processes but lack the money and in-house expertise. It also must solidify its position with the state's business community so manufacturers will turn to ITI for help with problems involving robotics and automated-manufacturing systems. Expanded cooperative research programs with industry and universities will be necessary to explore new concepts and find new products and business spin-off opportunities. To achieve the national reputation necessary to attract new firms, the center also must gain the recognition and confidence of federal research agencies.

Ultimately, ITI's success as a center of excellence will be measured by the extent to which it develops a reputation as a "greenhouse" of transferable manufacturing methods and techniques and a proven track record as a pragmatic manufacturing technology problem-solver.

Michigan Biotechnology Institute

The high technology task force identified biotechnology as "the foundation for the coming revolution in man's ability to synthesize and alter natural products and processes and thereby to literally reshape the agricultural, forestry, chemical, fuel, and other industries."[55]

The Michigan Biotechnology Institute was founded in 1981 to promote prospective opportunities. It began operating in October 1982. Unlike ITI, which seeks to shore up established durable goods industries through innovation, MBI will work to increase the commercial application of biotechnology discoveries.

In a recent study, the Stanford Research Institute estimated that the commercialization of new biotechnological techniques in the forestry and agricultural industries could add $750 million annually to state income and create 50,000 new jobs.[56] The concentrated activities of MBI, therefore, could help place Michigan at the forefront of this revolution and bring its profits to the state.

In order for this new industry to develop, MBI's first tasks included:

- o coordinating and linking industry and university research to the state's existing strengths in these sectors;
- o devising methods to transfer quickly and efficiently research discoveries to companies and subsequent products to the marketplace;
- o establishing a technology resource center for companies and entrepreneurs; and
- o structuring training programs for prospective workers in emerging biotechnology industries.[57]

Like ITI, MBI benefits from the strong connections among government, business, universities, and foundations that have given each center access to foundation money and prestige. Battle Creek and Lansing lobbied intensely for this center, recognizing the opportunity for local economic diversification and the job and investment benefits that hosting it could bring. The East Lansing location eventually was chosen because of its proximity to Michigan State University, an academic center doing advanced biological research.

University Relationship

MBI has established a good working relationship with the relevant university departments, an important task for a center hoping to gain scholarly stature in an emerging field. Six joint MSU-MBI professorships have been authorized. They offer the organizational stability and title perquisites necessary to attract top talent and provide the Institute with credibility in the biotechnology field.

The MBI growth plan projects a staff of 150 persons by 1993. Twenty-six of these will be adjunct scientists -- university professors who devote 20 percent of their time to MBI (according to standard "release-time" contract procedures). Some 62 staff will be project interns -- graduate or post-doctoral students working full time for MBI on biotechnology research and projects.[58]

The Institute currently leases office space and five lab stations from MSU. It also has access to the university's fermentation pilot plant and advanced instrumentation centers in biotechnology, facilities which MBI can use to build up its own research and development capacities. Under a flexible lease arrangement, MBI will lease space from MSU until its permanent facility is completed, probably in 1987.

This cooperation has developed naturally from MBI's orientation and comity with the scholarly environment. (ITI, geared more to industrial technology transfer and problem solving, has fewer university ties.) This academic "fit" has paid early dividends. Dr. Gregory Zeikus, formerly a research professor, was chosen as director. He has moved to integrate biology and engineering sciences to promote product and process development. He has directed research toward developing renewable resource technologies and bioprocess systems to an "economically viable" stage.

Some within MSU see the center as competition for the university and have cautioned against a totally "open arms" policy. This viewpoint has some validity. Even though work projects are disparate, foundations and other funding sources tend to overlap. Cross-utilization of staff tends to blur the distinction between the two entities. To its credit, MSU is beginning to harness the synergy that such competition spawns, using its relationship with MBI to further its own curricular and research objectives. Both institutions realize that the relationship, if properly managed, will be more of an asset than a threat. The biology department has tapped MBI expertise in developing one of the first biotechnology courses. The center is generating "free" faculty for MSU through joint appointments, while MSU is touting MBI facilities and research opportunities as a recruitment vehicle for its own departments.

Resources and Staff

The Institute received its initial funding through a $6 million state MEDA grant. MBI also has won significant support from the W.K. Kellogg Foundation, which is providing a total of $20 million in two stages. MBI is pursuing a strategy similar to that of its sister center, namely, attracting sufficient capital to support highly talented personnel and underwrite construction of a high-caliber research facility.

Current Operations

One of MBI's earliest projects was sponsoring an in-depth study of the economic impact of biotechnology on Michigan's economy. The results of this study were used to help MBI refine and sharpen its subsequent research program and priorities.[59] It reflected the extent to which state officials examined this industry for future growth potential before making significant resource commitments.

The center has taken a hard look at its objectives and mission and structured its functions accordingly. MBI is working with both new and established applied microbiology organizations to introduce and develop new agriculture and forest products and processes based on recent research. Its basic functions are:

- o developing a central facility for research and training;
- o undertaking collaborative research programs with several state universities; and
- o encouraging strong industry-university relationships to bring new companies to Michigan, new firms into existence, and new products to market.[60]

Because MBI's focus is on developing products for the future, rather than on modernizing processes of the present, its progress has been more modest than ITI's. Center development has required more planning and analysis. Still, MBI planned staff increases would permit it to generate about $150,000 in contract research revenues by 1986, supporting 7 percent of its operations. Eventually, MBI plans to be 80 percent self-sufficient.

The Institute hopes to achieve national and international stature by the end of the decade. It has embarked on a path that puts that goal within

reach. Yet MBI's business plan objectives will be more difficult to realize than ITI's. Emphasizing new and future industries offers a less certain trail. This center for excellence has not yet been able to attract many corporate sponsors. MBI intends to work with smaller companies to bring research ideas and results to the brink of commercialization, but let the private sector take them over the last hurdle to market. This reflects its desire not to compete with Michigan venture capitalists and marketing firms able to take the next step. This decision not to undermine private market forces is appropriate, but it does blunt MBI's revenue-raising capabilities.

The center's long-range business development strategy calls for expanding the state's limited economic base and developing new companies and employment opportunities in the biotechnology field. Nonpublic support for MBI's projects will be derived mostly from licensing, royalties, stock transfers, and limited partnerships.[61] In the near term, however, MBI will concentrate on contractual research leading to product development. In addition to state and foundation support, the center also will conduct fee-based seminars and short courses.[62]

The center has built its base successfully and now is poised for further growth. It has planned a highly innovative approach to new technologies suitable for commercialization. It can not only tap biological and engineering science efforts and business expertise but also provide the facility and resources for their amalgamation. State and center officials believe this "integrative and targeted" approach has the ingredients for success that most research institutions and universities lack, and that this will be a key to attaining private-sector acceptance.[63]

Metropolitan Center for High Technology

The third center for excellence, the Metropolitan Center for High Technology (MCHT), is located near downtown Detroit. It is a conventionally organized and operated business incubator facility established to house emerging high-technology companies. Located in the former S.S. Kresge world headquarters building since October 1983, MCHT provides low-rent space for start-up companies.[64] A Small Business Development Center within the complex provides some technical and support services for tenants. MCHT was established, in large part, to provide a "center of excellence" presence in an inner-city area.

MCHT was formed through the joint efforts of the state, the city of Detroit, and Wayne State University, which serves as the center's primary technology base. MCHT shares the mission of the other centers, namely, promoting commercially viable spin-offs of research and development findings, especially those of small entrepreneurs. At the time of its founding in 1981, medical and computer-related technologies were selected as the primary focus because of Wayne State's considerable interest and strengths in these areas. MCHT continues to pursue them; it is also trying to promote a technological capacity in vehicular electronics.[65]

The public-private-university partnership established at MBI and ITI is the objective of this center as well. However, MCHT has not achieved this coordination to the same extent. The incubator has struggled to overcome start-up difficulties, including site preparation for companies in its facility. Furthermore, MCHT has had difficulties raising venture and operating

capital for its new enterprises. Few have been able to procure enough to begin operating within the incubator. MCHT president Bert Ebi has outlined a proposal for a seed capital fund to be put into place during 1985.[66]

Proposed Centers

With the business incubator and two institutes underway, state officials are beginning to explore the possibility of setting up centers for excellence in other fields. In early 1985, the state legislature agreed in principle to fund a new Michigan Materials and Processing Institute. This center would conduct applied research in manufacturing materials and work to develop improved assembly-line and other manufacturing procedures.[67] Like the others, its overall efforts would be directed toward commercial applicability of research developments.

In late 1984, the cabinet council proposed that Michigan establish a new Michigan Industrial Technology Deployment Service (MITDS) agency in 1985. This agency would work to complement the efforts of all centers for excellence. As envisioned, MITDS would provide specific technical assistance and other support to businesses making the transition to computer-based industrial technology, help other government agencies evaluate business-development resources provided to small manufacturers, and promote technological cooperation among small manufacturers in Michigan.[68] MITDS would bring together development-finance resources, job-training assistance, and scientific and technical advisors from a variety of sources, including ITI. The cabinet council is preparing a final recommendation on MITDS for the governor's consideration.

Michigan Strategic Fund

State officials recognized that stimulating industrial and commercial diversification and developing the "factory of the future" would require recomposition of some state development finance mechanisms. Programs offered by the Michigan Economic Development Authority and the Job Development Authority (JDA) had been adequate in most cases, but development officials realized that they were largely uncoordinated and too limited in scope to fill the needs of the centers. Therefore a "strategic investment fund" was created in late 1984 to combine the resources of the MEDA and JDA. The administration pledged to bolster them with additional state funds and revenue-raising authority to "provide a greater range of investment capital to Michigan businesses."[69] Like most state economic development programs, the Michigan Strategic Fund (MSF) promotes economic growth and job creation by providing financial assistance to promising companies and projects. Unlike the traditional MEDA and JDA financing tools it eventually will replace, however, the MSF will:

- encourage public-sector flexibility in addressing the varying resource needs of rapidly changing industries and technologies;
- pyramid available state funds by requiring "significant private-sector financial support"; and
- provide incentives to lenders and businesses to encourage public-private financing partnerships that share both risks and benefits.[70]

This combination of elements increases the investment potential and versatility of the strategic fund and sets it apart from the more conventional programs of other states.

The fund is administered by a nine-member board of directors which includes the state treasurer and the director of the Department of Commerce. The board will review state programs and policies affecting business development and diversification and direct MSF efforts to enhance the state business climate.

The MSF is empowered by statute to issue bonds and notes to finance projects and to make grants, loans, and investments in development projects. It also may contract directly for construction, repair, and acquisition of economic development projects.[71] The statute assigns to the fund all MEDA and JDA powers and functions. Planning for this transition is underway; the changeover will be completed by October 1985.[72]

The authorizing legislation structured the strategic fund to establish six "centers of assistance" completely separate from the centers for excellence. Most have not yet progressed past the paper stage; when operating, each will target a specific business-financing need.[73]

The first of the six centers to receive an appropriation (for $9 million), the Center for Product Development, will finance new processes, techniques, and products that have advanced beyond the experimental stage and could be developed commercially. This center will assist entrepreneurs who could not otherwise obtain financing to take their product to market. Recipients will be required to enter into a venture agreement with MSF granting it a portion of future sales proceeds.

The Center for Assistance to Private Enterprise will make loans to SBA-eligible certified development companies or small business lending corporations and directly to private companies for development projects to create or retain jobs within Michigan. (Housing and retail sales activities are not eligible.) It will assist only projects that can attract at least 20 percent of their financing requirements from private sources.

The Center for Research and Development will help companies developing new technologies and exploring the application of the most promising ones to industry. The center may finance the design and construction or remodeling of facilities, acquire property, and provide initial working capital for operating costs. In conjunction with this center, the MSF board will name a higher education coordinating council to advise on research and development facilities established by higher education institutions.

The Center for Assistance to Local Government will help municipalities by providing direct loans and loan insurance and guarantees for public works projects needed to attract private investment.

The Center for Loan Insurance will complement other financing activities by procuring or (when necessary) providing insurance, letters of credit, or guarantees of public or private loans, leases, and revenue bond issues.

The MSF board may certify minority venture capital companies through a Center for Minority Venture Capital. This center could provide additional

state business tax credits equal to 40 percent of the investment in these companies.

As these brief descriptions suggest, the MSF is structured to remove the rigidity of most public-sector development tools and to expand their applicability to a broader range of needs at various stages of business development. Obviously, only experience with actual program operation will show whether these six centers can retain their fundamental identity or if this division of responsibility is most appropriate. If MSF functions as planned, it will have several advantages over conventional financial-assistance programs.

- The level of flexibility will enable the MSF to assist both new-born businesses seeking their first cash infusion as well as more mature companies in need of a backstop guarantee or affordable loans to expand or diversify.

- MSF requires a substantial level of private-sector participation, both in financing and -- through its board of directors -- in administration.

- The strategic fund has broad financial powers and discretion, enabling it to assist emerging growth companies that ordinarily would not meet most bonding and lending criteria.

- By claiming royalties and revenues in exchange for taking investment risks, the MSF will build credibility with the private sector it looks to for financial leverage and compound its own resources.

Thus, the fund is structured to channel public capital more efficiently into projects with significant long-term growth and employment prospects while enhancing the finance mechanisms of the marketplace.[74]

V. State-Assisted Venture Capital Program

State and local government participation in equity capital finance is a recent phenomenon. In most places, the public sector has played a successful although limited role, such as providing technical assistance to entrepreneurs, facilitating contacts between entrepreneurs and venture capital sources, and promoting venture capital deals locally. Michigan was in this position prior to 1983.

As Michigan's government and business leaders grappled with the increasing structural unemployment of the last recession, they saw the need to encourage the development of high-technology and growth industries in an effort to replace some of the jobs lost in the durable goods manufacturing industries. As mentioned, new economic development depends on several public and private ingredients; Michigan -- even in the midst of recession -- could offer most of them. However, as both the public and private sectors worked to structure job-generating projects, one key component often was lacking -- capital. Only $35 million in venture capital was invested in Michigan during 1982, compared to $718 million in Massachusetts and nearly $1.3 billion in California.[75]

The Treasury Department, at the direction of Governor Milliken, forged a program to spur needed venture capital investment within the state. In 1982, the legislature passed a law which placed Michigan in the forefront of public-sector venture capital efforts. That law, which earmarked up to 5 percent of the state's pension monies for such investment, gave Michigan the largest publicly managed venture capital pool in the country. The fund was launched in 1983 and by March 1985 nearly $40 million had been invested in 23 companies (90 percent in Michigan). Another $78 million was committed to other venture capital funds. Even with these investments, over $350 million was still available.[76]

The Venture Capital Process

The venture capital process involves high-risk, high-return investments. Venture capital deals require more intensive analysis of the business concept than conventional bank underwriting. Each deal is uniquely structured but requires some form of management participation by the financier. The venture capital industry remains relatively small, with an estimated 550 firms operating in the United States. About 200 of these are private partnerships

and the balance are corporate-sponsored funds and Small Business Investment Companies (SBICs).[77]

The venture capital process ties together a product or service with an identifiable market need, entrepreneurial and management talent, and the investment capital necessary for development and financing. A venture capitalist links these ingredients together. This type of investment is intensive and long-term, generally entailing a five- to seven-year commitment. Its basic premise is that joint entrepreneur-investor efforts will yield substantial profits, usually six to ten times the initial investment. Most venture capitalists finance only 1 or 2 percent of the prospective deals they review.[78]

The industry has evolved into distinct segments; most venture capitalists direct their investments into one or two of them. These stages of corporate development include:

- o seed financing to develop a concept;
- o start-up investment in product development and initial marketing (usually to companies just organizing or in business only a short time);
- o first-stage financing for companies that have spent development funds and need additional resources to launch commercial manufacturing and sales;
- o second-stage financing for initial expansion of a producing company;
- o third-stage assistance, in the form of funds for expansion, product improvement, or working capital for a growing company; and
- o bridge financing for a company expecting to go public within a year.[79]

In 1983 nationwide, 46 percent of all venture capital investments took place in computer and related industries, 13 percent in communications, and 10 percent in other electronics industries.[80] Table 5 shows the geographic distribution of venture capital firms and their resources in 1982.

In 1982, Michigan clearly was lagging behind many other states, only one step from the bottom in the Midwest in the amount of venture capital invested. However, venture capital companies began to take an interest in Michigan when the recession of 1981-82 forced many companies to innovate and modernize in order to remain viable. The state pension fund program was developed to take advantage of that circumstance.

TABLE 5

Geographic Distribution of Venture Capital Investment Entities and Resources in 1982

Region and State	Entities	Capital[1] (millions of dollars)
New England		
Connecticut	21	207
Maine	1	1
Massachusetts	63	986
New Hampshire	1	n/a
Rhode Island	3	93
Vermont	2	3
Total	91	1,290
Mid-Atlantic		
Delaware	0	0
Maryland	4	61
New Jersey	18	149
New York	135	1,538
Pennsylvania	22	70
Total	179	1,818
Midwest		
Illinois	26	739
Indiana	6	1
Iowa	6	50
Michigan	12	17
Minnesota	15	145
Ohio	17	145
Wisconsin	6	20
Total	88	1,117
South		
Total	121	648
West		
Total	152	1,628
U.S. Total	631	$6,501

[1]Capital amounts are understated in some cases because some firms did not report total funds under management.

SOURCE: Stanley Pratt, Guide to Venture Capital Sources (Wellesley, Mass.: Capital Publishing Co., 1982), p. 48.

Michigan's Venture Capital Program

Establishing the Program

Legislation creating the program, formally known as the Venture Capital Division in the Treasury Department's Bureau of Investments, took effect in April 1982; the first deal was completed in December of that year. This act authorized the state treasurer to oversee the investment of up to 5 percent of the assets of five state retirement systems in small business or venture capital firms on an equity, debt, or warrant basis.[81] This was a very bold step, considering the size and coverage of the pension funds -- currently $9 billion in assets covering all state school employees, workers, police forces, and the judiciary.

The Treasury Department developed program guidelines with four objectives:

- realizing an above-average, long-term return on investment through participation in projects with substantial growth potential;
- using the program when possible to preserve or create jobs for Michigan residents by assisting small business development within the state;
- emphasizing investments in new or emerging high-growth companies offering products and technologies that could help diversify the state's economy; and
- pyramiding the access and flow of venture capital to Michigan's business community by seeking companion sources of investment funds.[82]

The state participates in the venture capital process as a direct institutional investor with its own portfolio of companies and as a limited-partner investor in other venture capital groups. The program portfolio is managed by the fiduciary officer of the pension fund. Its first director, a former Wall Street investment analyst, recruited a local banker as well as Department of Commerce staff who "knew their away around" economic development and finance and could deal with embryonic companies.[83]

Investment Parameters

Michigan venture capital investments are directed to "businesses with strong management that show a substantially above-average potential for growth, profitability, and equity appreciation."[84] Program officials emphasize the fact that traditional sectors can and do benefit from the program and that growth rather than technology is the primary factor weighed in evaluating the deal. Both high-technology and existing-technology business proposals are considered, but companies ultimately obtaining assistance are those with unique products, services, or market positions providing a "proprietary competitive edge."[85]

In implementing the program, which currently has $450 million in total capital available, the Venture Capital Division has adopted numerous investment criteria and policies. Several of these are described below.

- The fund pursues a diversified type of investment portfolio with an emphasis on high-growth firms.

- Initial investments are at least $500,000, and preferably are in the $2-million to $10-million range.
- The targeted annualized return is at least 35 percent.
- A five- to seven-year term of investment is expected, and an exit path must be evident at the time of funding.
- Real estate investments and proposals involving working capital targeted specifically to retire debts or pay salaries are not considered.
- On a selected basis, the venture capital fund makes out-of-state investments in order to diversify the portfolio.
- The fund focuses on second-stage or later project financing and will not function as a seed capital fund for start-up companies.
- Firms assisted have to be in a position to meet standard underwriting criteria (usually meaning that they have been operating for two or three years).[86]

In its first years of operation, the fund projected a return competitive with the national market average. Deals take from two to four months to conclude, a time frame similar to other venture capital companies. The current goal is to complete eight to ten deals a year.[87]

The program's investment philosophy has been characterized as "middle of the road".[88] Clearly, fund managers must take a hard look at the more risky proposals, since they are investing public pension funds. The venture capital program has a fiduciary responsibility to make money for the state retirement system, although its overseers are cognizant of its complementary objective of making investments that will lead to new employment opportunities within the state. This cautious approach means, though, that the state fund is not able to assist with seed or start-up capital investments in promising new companies, and the opportunity to encourage even greater development and job creation is thus reduced.

Program Activities

The venture capital program has been promoted widely by state officials and well received by the Michigan business community. It has gained considerable national attention and been highlighted by the President's Commission on Industrial Competitiveness and the Small Business Administration, among others. Because of this publicity, the Venture Capital Division now receives an average of 50 business plans a month.

Five staff members analyze proposals in-house. They hold preliminary screening meetings with the plan's principals to make the program rules clear and eliminate obviously unsuitable proposals. Other requests typically require staff time to finalize business plans, inspect company property and products, and structure corporate documents. Staff members spend close to 75 percent of their time monitoring current investments; this limits the time they can devote to new projects.[89]

Division staff strive to operate the program like "a regular [venture capital] company," conforming to accepted industry standards.[90] This includes a decision-making process free of intervention by elected officials. At the outset, state officials realized that politics could taint the program and severely damage its credibility with other venture capitalists. The fiduciary and legal responsibilities of the pension fund managers provide another reason to maintain a politics-free program.

The fund invested $82 million and committed an additional $43 million from its first complete package in 1982 through June 1985, for a total of $125 million. Its activities include:

- o twenty-two direct investments in specific companies within Michigan, ranging from $116,223 to $6 million, averaging $1.8 million;
- o three direct investments totalling $3.25 million (or 8 percent of all direct investments) in companies located in California, Massachusetts, and Oregon;
- o investments and commitments totalling $50 million as a limited partner in seven other venture capital funds operating in California, Connecticut, Massachusetts, and Wisconsin; and
- o investments and commitments totalling $28.2 million in three other Michigan-based venture capital funds.

Ninety-two percent of the direct investments were made in Michigan firms through March 1985.[91]

The fund has encouraged commercialization of industrial automation and robotics technologies -- industries directly associated with Michigan's economic revitalization. The program also is credited with creating some 1,350 jobs, even though the businesses helped are still in their formative stages. Its directors recognize the job-generating potential of encouraging entrepreneurs and assisting new businesses, even though the program was not structured specifically as an economic development or job-creation program. Table 6 provides details on projects in which the Michigan venture capital program has invested directly.

Nearly two-thirds of the total investments were made as limited partners in other venture capital pools, however, in order to develop relationships with other companies. Nearly 21 percent were placed in other Michigan funds. Coinvestment is a common venture capital practice with important payoffs: companies share risks and opportunities, provide additional strengths to individual funds, encourage reciprocal investments, and develop credibility and professional confidence with other venture capitalists. For publicly capitalized efforts like the Michigan fund, coinvesting (see Table 7) is the best way to overcome the most common concerns about these programs, such as geographic limitations or level of management expertise.

TABLE 6

Michigan Venture Capital Fund Direct Investments
(December 1982 - March 1985)

Product	Total Investment	Employees
Michigan		
Machine vision systems	$4,500,000	90
High speed printers	2,505,000	99
Biological research	350,000[1]	9
Laser welders	3,300,000	165
Synthetic vision systems	4,000,000	35
Medical diagnosis apparatus	603,110	8
Telecommunications	2,278,946	437
Computer software	200,000	8
Polymers	643,800	14
Computer software	1,200,000	82
Computer peripherals	1,883,370	48
Computer peripherals	778,689	25
Computer peripherals	200,000	18
Industrial robots	6,000,000	170
Machine vision	1,999,998	52
Food packaging	150,000	25
Tape cartridges	600,000	28
High alloy castings	116,223	12
Recreational vehicles	3,012,425	10
Computer software	1,500,000	15
Total	$35,849,023	1,350
Out of State		
Medical instruments	750,000	n/a
Ambulatory clinics	500,000	n/a
Precision robotics	2,000,000	n/a
Total	$3,250,000	
Total Direct Investments	$39,099,023	

[1]Includes $176,130 committed but not yet invested.

SOURCE: Michigan Department of Treasury, Venture Capital Division, unpublished data.

TABLE 7

Michigan Venture Capital Fund
Limited Partnership Investments in Other Funds
(June 1983 - March 1985)

Fund Location	Invested to Date	Additional Committed	Total Investment
Midland, MI	$ 4,200,000	$ 7,800,000	$12,000,000
New Canaan, CT	7,000,000	3,000,000	10,000,000
Menlo Park, CA	2,500,000	7,500,000	10,000,000
Boston	1,666,666	3,333,334	5,000,000
Boston	1,750,000	3,250,000	5,000,000
San Francisco	3,333,333	6,666,667	10,000,000
Racine, WI	2,500,000	2,500,000	5,000,000
San Francisco	1,925,676	3,074,324	5,000,000
Midland, MI	5,249,999	9,749,998	14,999,997
Ann Arbor, MI	400,000	800,000	1,200,000
Total	30,525,674	47,674,323	78,199,997

SOURCE: Michigan Department of Treasury, Venture Capital Division, unpublished data.

According to the President's Commission on Industrial Competitiveness, the fund has "definitely increased" the flow of venture capital into Michigan and the Midwest.[92] Furthermore, the strategy of coinvestment has brought new outside venture capital into Michigan through syndicated deals.

The venture capital process is highly competitive. As the Michigan fund grows, it will face increasing pressure from other large pools to ferret out good deals and maintain a good performance record. It will have to overcome obstacles associated with expansion and success. Its distance from state government and elected officials does not eliminate some inherent limitations. For example, since staffing is such a key element in program success, the Michigan program could be impeded if its highly capable staff were wooed away by private companies offering higher salaries and benefits. The public-sector Michigan fund might be prohibited by administrative and statutory provisions from matching these offers.

The Michigan venture capital fund has gotten off to a promising start. While it is too early to judge its overall portfolio management performance, several ingredients of administrative success can be identified. Program officials have struck the right balance between related program objectives. Staff have worked to make venture capital investments that take into account the state's economic development needs and advantages and support its revitalization strategy. The fund also has achieved credibility and an important degree of acceptance within the venture capital industry. The office has adhered to industry standards, and separated itself successfully from other aspects of state government and politics.

VI. Improved Business Climate

Surveys often have categorized Michigan as an unattractive state in which to do business, a place where company needs and interests were subordinated to those of every other constituency. The state's major attractions, its highly skilled labor force, breadth of business-assistance programs, and concentration of manufacturing facilities, often were overshadowed by businesses' perceptions of high-wage scales, adversarial labor-management relations, and an overly stringent regulatory atmosphere.

This viewpoint is beginning to change, thanks to the improvement in Michigan's business climate in the last few years. Essentially, the need to generate new jobs has motivated state officials and private industry to make changes. Soon after his inauguration, Governor Blanchard directed his staff to review state laws, regulations, and practices that were deterring job-creating investments. The cabinet council launched a major effort to eliminate these impediments -- a process whose first phase took nearly 12 months of intensive effort. The council decided on a two-pronged strategy. First, it based initial actions on recommendations of a survey of business conditions conducted by the Milliken administration in 1982. Second, it concentrated on those issues where positive steps could be taken easily to develop a greater level of confidence with businesses and interest groups, thus creating momentum for subsequent actions. Overall, the maxim that "nothing succeeds like success" clearly was a guiding principle.[93] The council's specific moves included:

- creating a business ombudsman and installing industry experts and advocates within state agencies;
- cutting business reporting and other paperwork requirements;
- encouraging business start-ups through incubation centers;
- eliminating regulatory barriers against franchise operations and securities registration;
- reducing workers' compensation costs; and
- easing the corporate tax for new and small businesses.

It is the combination of all these improvements that have made this initiative successful to date. Few jurisdictions have ever implemented so comprehensive a package in so short a time. According to state officials and private-sector representatives, business owners who overlooked the state in the past "would reconsider Michigan now."[94]

From the beginning, state policy makers were challenged to structure incentives effectively while garnering the support of business, consumer interests, and the bureaucracy. As the process unfolded, the council discovered that business and consumer groups were able to work together -- once they were assured that their considerable efforts to reach consensus would prove mutually beneficial. The governor emphasized to consumer groups that public interests would not be compromised. He also assured business groups that he would take their concerns seriously and that results of the effort would not become mere window dressing. The joint business-consumer approach prodded the bureaucracy into accepting the changes; with its major client sectors in agreement, the bureaucracy could not play them off against one another.[95] This cooperative effort for regulatory reform was the most welcome part of the process. The individual initiatives are described below.

Establishing an Ombudsman Office

While many cities and states have initiated business hotlines or contact offices, Michigan has put in place a comprehensive results-oriented ombudsman operation that has won wide acclaim from state businesses. Its success is due, in large part, to the real support of the governor and top officials in state agencies. This backing has given the ombudsman staff the necessary stature and authority to carry out their prescribed functions.

The office, created by executive order, was opened in November 1983. Housed in the Department of Commerce, the director is a gubernatorial appointee with necessary access when intervention is needed in particularly troublesome situations. Thus, the two circumstances often cited to explain the minimal effectiveness of this type of operation -- lack of authority and access -- were recognized and avoided when the Michigan office was established.[96]

In addition to a director, there are eight assistant ombudsmen, each functioning in a specific area, including environment; labor; treasury and taxation; building and construction codes; fees, inspection, and licensing; public health; and liquor. The governor asked each state agency and bureau to designate a high-ranking liaison with the ombudsman office, and most have specified either the director or deputy director. This sense of accountability and high-level visibility throughout state government has strengthened the nascent program further.

From its inception through mid-February 1985, the office handled 10,900 calls:

- One-half requested information on basic permits and licenses (since the office has absorbed Michigan's one-stop permitting center);
- one-quarter conveyed complaints or problems with state rules, procedures, fees, or quality of service; and

FIGURE 5

Advertisement for the Michigan Ombudsman Office

Things are changing in Lansing for business.

In the not so distant past, businesses seeking assistance in Lansing were confronted with a simple dilemma: who, out of the confusing maze of boards and bureaus, sections and subsections, offices of This, That, and The Other Thing, could listen and help?

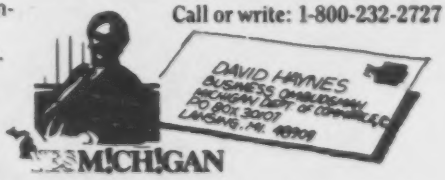
Fortunately, that's changing now. As evidence, we submit David Haynes.

David is our Business Ombudsman. As part of our drive for new efficiency and responsiveness, David acts as a mediator for businesses dealing with state regulatory agencies. His Office of the Business Ombudsman is a kind of "one-stop shopping center" where you can easily obtain assistance in getting necessary permits and licenses, and get help in cutting government red tape. Best of all, he's fast. David's office will begin helping you within 72 hours of your first contact.

Since we created the Office of the Ombudsman, the response has been an average of fifty calls a day.

That proves to us what we've always suspected was true: not that Lansing and business weren't talking — we just weren't talking to each other. Well, the lines are open now.

Call or write: 1-800-232-2727



MICHIGAN

Michigan business, the answer is yes.

- one-quarter sought financial information or assistance -- inquiries which are forwarded to state financial packagers after initial screening.[97]

The staff also received frequent inquiries on related local government matters; although out of ombudsman jurisdiction, they were able to make suitable referrals in about half these cases.[98]

The most important features of the program are that it centralizes license and permit requirements and tracks and channels the results of office actions. Both of these procedures are totally computerized. The "Michigan Business Ombudsman On-Line System" was developed to provide a response to business inquiries within 72 hours of initial contact.[99] New forms and worksheets were devised to collect basic information and solve problems; they help assure consistent treatment and make the data compiled useful in analyzing specific rules or requirements. This data resource also has great potential for future applications throughout state government.

Central License and Permit Capacity

New firms and expanding companies have reacted favorably to the newly set up clearinghouse for permits; major business organizations have found it to be an effective operation directed by cooperative staff.[100] To provide the service, the intake specialist defines the company's information needs in four steps: business description; Michigan business classification -- a state-tailored standard industrial code (SIC), business subcategories, and other industrial characteristics.[101] With this information, ombudsman staff can produce a list of all required permits and licenses with each issuing department and agency specified and contact telephone numbers included in many cases. This list is sent to the inquiring business with anything else that the system, which has been programmed to search for relevant information, may provide. They could be references to useful state publications, explanation of SBT provisions, and so forth. Packets of supplementary materials pertinent to the inquiry are assembled from the intake form and response letter.[102] This system is simple enough that part-time staff and student interns can do most of the work.

Figure 6, an actual response provided to a person starting a landscaping service, shows the full scope of this information. The computer-generated letter is based on the intake form, which lists business needs and such information as number of employees and start-up date. The form also summarizes the business classification information used to trigger the response.

Office Actions

Ombudsman staff take a variety of actions to deal with business complaints or issues. They can:

- forward the inquiry to appropriate technical or financial staff in other departments for resolution;
- facilitate a meeting between parties (usually a business owner and a state regulatory agency) to negotiate a solution; or
- refer particularly sensitive or significant cases to the cabinet council.

FIGURE 6

Michigan Business Ombudsman Permit Information

CALL DATE: 07/20/94
CALL TIME: 02:16 CUSTOMER NUMBER: 844205

INTAKE SPECIALIST: CINDY DOUGLAS

DEAR MR.

THANK YOU FOR YOUR CALL TO THE MICHIGAN BUSINESS OMBUDSMAN OFFICE. THE FOLLOWING LIST OF LICENSES AND PERMIT APPLICATIONS MAY BE REQUIRED FOR YOUR NEW BUSINESS. ALSO INCLUDED ARE ANY PAMPHLETS RELATING TO YOUR BUSINESS. WE HOPE WE HAVE BEEN OF ASSISTANCE TO YOU AND ENCOURAGE YOU TO CALL US AT 1-800-232-2727 IF YOU HAVE ANY FURTHER QUESTIONS.

DAVID HAYNES
MICHIGAN BUSINESS OMBUDSMAN

BUSINESS DISCRIPTION: TREE TRIMMING
STATE OF MICHIGAN BUSINESS CLASSIFICATION: AGRICULTURE, FORESTRY, AND FISHING
SUB-CATEGORY: AGRICULTURAL SERVICES
SPECIFIC: ORNAMENTAL SHRUB AND TREE SERVICES

	FORM NUMBER	PERMIT/PAMPHLET	ISSUING DEPARTMENT	AGENCY
___	590071	PERMIT TO CONSTRUCT, OPERATE RIGHT-OF-WAY STATE TRUNK LINE. NEEDED TO CLOSE OR USE STATE RIGHT-OF-WAY OF A STATE TRUNK LINE FOR LAYING CABLE (FOR PAY TV) AND BUY UTILITIES	TRANSPORTATION	UTILITIES/PERMITS
___	590072	MISC. OPERATIONS WITHIN TRUNKLINE RIGHT-OF-WAY USED FOR MISC. PURPOSES WHICH PARALLEL WITH PERMIT #590071	TRANSPORTATION	UTILITIES/PERMITS
___	790037	COMMERCIAL PESTICIDE APPLICATORS LICENSE OWNER OF BUSINESS - PEST CONTROL, SPRAY COMPANIES, SELF EMPL OYED APPLICATORS, FRANCHISE (ORKIN) ETC. PHONE: 517-373-1087	AGRICULTURE	PLANT INDUSTRY
___	790038	COMMERCIAL APPLICATOR CERTIFICATE, OCCUPATIONAL LICENSE PREREQUISITE TO COMMERCIAL APPLICATORS LICENSE. OCCUPATION TO WORK FOR A LICENSES PEST CONTROL BUS. PHONE: 517-373-1087	AGRICULTURE	PLANT INDUSTRY
___	790043	PRIVATE PESTICIDE APPLICATOR CERTIFICATE REQUIRED WHEN PESTICIDES ARE PURCHASED AND USED BY HOMEOWNER FOR PERSONAL USE. . PHONE: 517-373-1087	AGRICULTURE	PLANT INDUSTRY

FOR YOUR TYPE OF BUSINESS YOU SHOULD ALSO REGISTER THE ASSUMED NAME OF THE BUSINESS AT THE COUNTY CLERK'S OFFICE AS A SOLE OWNER OR A PARTNERSHIP.

PLEASE COMPLETE THE ENCLOSED APPLICATION FOR EMPLOYER NUMBER, FORM SS-4, AND RETURN IT TO THE INTERNAL REVENUE SERVICE. THIS WILL REGISTER YOUR BUSINESS WITH THE FEDERAL GOVERNMENT FOR TAX PURPOSES.

EVEN THOUGH YOU MAY NOT BE EMPLOYING WORKERS AT THIS TIME, YOU SHOULD REGISTER WITH THE MICHIGAN EMPLOYMENT SECURITY COMMISSION. YOU WILL BE PLACED ON A MAILING LIST AND ADVISED OF UPCOMING WORKSHOPS COVERING UNEMPLOYMENT INSURANCE, INCENTIVES FOR HIRING, TAX CREDITS, AND MORE. A FORM IS ENCLOSED FOR YOUR CONVENIENCE, AT YOUR REQUEST A FULL EMPLOYER PACKET IS AVAILABLE FROM THE BUSINESS OMBUDSMAN OFFICE.

BECAUSE YOUR ANNUAL GROSS INCOME WILL NOT EXCEED $40,000, YOUR BUSINESS IS EXEMPT FROM THE SINGLE BUSINESS TAX. IF YOUR GROSS INCOME SHOULD INCREASE TO $40,000 OR ABOVE, YOU SHOULD NOTIFY THE MICHIGAN DEPARTMENT OF TREASURY.

Many regulatory difficulties can be solved by addressing the rules themselves; the ombudsman office has worked with several agencies to initiate appropriate regulatory changes. In such cases, the ombudsman office may recommend:

- o Waiving a rule or requirement. Often, waiving regulation on a one-time basis or extending its compliance deadline can provide a business with the relief it needs.

- o Changing or eliminating a rule. Some state requirements are modified or eliminated because businesses have demonstrated that they no longer serve any public safety or regulatory purpose.[103]

These response categories have been included in the on-line data system; when the system is fully operational (anticipated in 1985), this information will be available for reporting to numerous state agencies, senior executive staff, and the legislature, as well as for monitoring activities within the ombudsman office itself. Staff have considered using such information to help with several related objectives, such as reducing unnecessary paperwork, suggesting changes in financial-assistance programs, focusing on problem-solving efforts as part of a business-retention strategy, or channeling new business concepts into the Michigan Strategic Fund.[104]

The on-line system also will permit easy inquiry into the status of cases before the office and serve other oversight functions. Eventually it will generate eight types of reports on everything from routine activities to program status and tailored information on:

- o regulatory issues for the food processing, forestry, and auto suppliers targeted industries;

- o obsolete regulations in and outdated state agency policies, and the basis for them; and

- o business inquiries outstanding for more than 30 days.[105]

Michigan's ombudsman program is off to good start. It is popular among state regulators, agency staff, and private businesses and entrepreneurs because it has worked. In examining the reasons for its positive performance, several key ingredients emerge:

- o strong support of high-level administration officials;

- o credibility of the ombudsman staff and private-sector perception that they are knowledgeable advocates and contacts within state government;

- o specializations keyed to the most common business needs, especially environmental and labor issues; and

- o extensive computer system and data base.

Reducing Paperwork

State officials determined that reducing the amount of required paperwork would reduce the cost of doing business in Michigan, and thereby help improve the state's business climate. Previous efforts to streamline business forms and reporting requirements were expanded and given new emphasis. The cabinet council directed a systematic review of state paperwork. Its objectives included:

- o eliminating nonessential and duplicate business forms as well as requests for information not required expressly by statute or regulation;
- o reducing compliance costs by simplifying or redesigning the remaining forms when possible; and
- o developing a statewide management information system and data base to control and monitor all state paperwork.[106]

The total number of business forms required by all 19 state departments is 2,834. Fifty percent of these forms are required by the Departments of Commerce, Natural Resources, and Labor. Therefore, paperwork review concentrated initially on these three agencies. To undertake the assessment, the cabinet council recruited experienced forms experts interested in this project from state departments and established a high-level business paperwork reduction consulting team. This group relied on program specialists in the three departments for substantive advice on administrative and data needs. Business trade associations surveyed their memberships and provided suggestions as to onerous or needless forms.

Eliminating Nonessential Forms

To meet the first objective of the review process, the paperwork reduction team examined each business form for obsolescence. The team also recommended consolidation of those forms required by more than one department that were essentially the same. In its first five months of work, the team studied 939 forms, some 66 percent of the business forms in the three targeted departments. Working closely with program staff, they recommended 268 forms for elimination -- 29 percent of the total.[107] Table 8 summarizes the results of the first phase of the review.

Reducing Compliance Costs

The second objective was to lower paperwork costs by focusing on essential information. Obviously, a number of forms were necessary for state data collection and reporting requirements, but many of these were poorly constructed, difficult to understand, and needlessly detailed. To improve the remaining forms, the paperwork team suggested changes including design alterations and removal of unnecessary information requests in forms that departments would continue to use.

TABLE 8

Paperwork Reduction Team: Activity Scorecard

Department	Number of Forms Reviewed	Forms to be Eliminated Number	Percent
Commerce	670	213	32
Natural Resources	171	47	27
Labor	98	8	8
Total	939	268	29

SOURCE: Janet Cox, Barbara McLeod, et al., "Business Paperwork Reduction in Michigan" (Lansing, Michigan: Business Paperwork Reduction Consulting Team, April 1984), p. 3.

Paperwork Data Base

The cabinet council's third objective was to institutionalize an on-going paperwork review capacity within state government. Accordingly, detailed information on every state form evaluated during the review process was entered into a computerized data base established especially for this purpose. This Michigan "forms catalog," the first of its kind in the nation, eventually will allow specified types of forms to be targeted for closer examination. When the catalog system is in full operation, it will permit state officials to identify forms used for the same purpose by different agencies, forms issued under questionable authority, or unusually lengthy forms, among others.

The agency review will continue until forms in all departments have been examined. The review in the three departments initially targeted has been completed. Analysis of paperwork requirements in the Departments of Public Health and Licensing and Regulation is in progress; Transportation and Agriculture will follow. The cabinet council anticipates that the entire review will be completed by late 1985.

In its April 1984 progress report, the paperwork team made several recommendations to winnow further paperwork requirements and improve paperwork management:

- place overall forms coordination in the Office of the State Forms Administrator;
- empower that office to take the lead in establishing a central forms management program run by technically trained forms specialists in each department;
- direct the office to explore creative uses of the forms data base to reduce business compliance time and costs even further;

- institute an "exceptional" reporting system in which a business need complete a form in its entirety only once, with subsequent filings correcting or updating only that information that has changed since the initial reporting; and

- devise simpler and less frequent reporting for small businesses where practical.[108]

In a related effort, legislation was adopted to encourage state agencies to show regulatory restraint with small businesses -- defined as those having fewer than 250 full-time employees or having gross annual sales of less than $6 million. Supported by prominent state leaders and business groups, it took effect in March 1985. The law requires that all agencies submit a small business economic impact statement as part of a regulatory package prior to rule promulgation. This new procedure is designed to make agencies aware of the paperwork and legal, consulting, and accounting expenses created for small business to comply with the rules.

The law also allows agencies broad powers in minimizing regulation. If the impact statement reveals that proposed or existing rules will have a disproportionate economic impact on a small business, the agency is directed to provide relief by:

- establishing different compliance or reporting requirements or timetables under the rule;

- consolidating or simplifying such requirements;

- establishing performance rather than design standards; or

- exempting small businesses from any or all of the requirements of the rule.[109]

According to the statute, one or more of these steps may be taken "when it is lawful and feasible in meeting the objectives of the act authorizing the promulgation of the rule."[110] If the adverse economic impact will be limited to very small businesses, the agency may target its rule exemptions to two subcategories: those enterprises with fewer than 50 or those with fewer than ten employees.

This mandate to "reduce economic impact" provides agencies with latitude to reinterpret rules for small businesses. The manner in which agencies choose to implement this provision could raise due process questions that will have to be resolved. It may also encourage the formation of small-scale firms whose size is determined by the ability to circumvent more stringent standards or to avoid the reporting stipulations required of larger businesses. Because this statute just took effect, the means of addressing such situations has not yet emerged.

The law also requires each agency to prepare a plan for the review of existing rules brought to the attention of the state business ombudsman. Businesses thus have a direct voice in the regulatory review process. If existing rules are discovered to have an inordinate economic impact on small businesses, the agency is empowered to rescind or modify the rule to eliminate it.

Many business owners favor the new legislation and the achievements of the business paperwork reduction consulting team because they feel both show that state government is serious about reducing paperwork. These changes have sent a "positive signal" to the private sector, according to the Michigan Manufacturers Association,[111] which believes that reductions in paperwork lower the cost of doing business in the state.

Business Incubation Centers

Like many states, Michigan has recognized the importance of small business development in its economic revitalization strategy. New small businesses need special care, however, since they fail at extremely high rates. In fact, business analysts have noted that 30 percent of all new firms fail within a year of their founding, and only 40 percent last as long as five years.[112]

Realizing that new small firms face serious obstacles when beginning operations, the legislature authorized the Michigan Business Incubation Act in July 1984. The state provides seed money to be used in conjunction with funds raised locally to pay for the conversion of designated buildings into business incubation centers. Modeled after a successful British small business assistance program, this act will give added momentum to the incubator concept, statewide.

Michigan has the labor force and technical expertise necessary to promote small business entrepreneurship; this program is expected to provide access to another ingredient necessary for economic development, namely, affordable space. New, small enterprises may take advantage of underused or abandoned shops, plants, and other facilities throughout the state. Local governments, schools, or other entities can appoint a community board (or authorize an existing development corporation or authority) to petition the state Department of Commerce for designation of a vacant public building as a business incubator.[113]

The state incubator program is just beginning. As of March 1985, no facilities had been designated, although the cities of Flint and Jackson had identified usable structures and were preparing applications. DOC is empowered to designate up to ten centers. Priority will be given to proposals that feature:

- significant job creation potential;
- local contribution of at least half of the money needed to renovate and operate the center, exclusive of rental fees, for at least three years; and
- evidence of business, labor, and education cooperation in the incubator center effort.[114]

No money has been appropriated yet for this program but the state legislature estimates that about $500,000 will be needed to fund the first incubation centers. Michigan officials believe that this program can encourage entrepreneurship, create more permanent jobs, and help small businesses overcome start-up hurdles that lead to their demise.

Easing Securities Registration

Until 1983, Michigan was among the most difficult states in which to register securities offerings. Developmental and venture capital companies faced so much work and expense in state merit review procedures that many apparently either never formed or located elsewhere. In a recent article, The Wall Street Journal described the Michigan securities regulation process as "legendary."[115]

The need to ease the registration process was clear to state officials, who worked hard to revise it both in substance and in the perception of business owners. The Treasury Department staff laid the groundwork for this initiative in 1982. The cabinet council formed a securities working group early in 1983. The state's new approach to evaluating corporate securities registration involves the prescription of circumstances under which full merit review of the offering is unnecessary. The working group concluded that this modification would provide greater flexibility for corporate equity offerings, make venture capital investments more attractive, and enhance business and job opportunities within Michigan.

This "rational merit"[116] securities regulation identifies in a common-sense way traditional market factors that reduce the need for government intervention. The rule assumes that a reputable underwriter taking on the risks of a large offering knows that the issuing party will offer fair terms to the public investor. It outlines three categories of offerings exempt from full merit review. Offerings conducted pursuant to a "firm underwriting" may avoid minute scrutiny. In these transactions the underwriter purchases an entire issue for its own account and the offering has been cleared by the federal Securities and Exchange Commission. This exemption is based on the premise that the underwriter will acquire reputable issues and, in order to maintain its own standing in the financial community, will work to ensure fairness. The federal approval also provides a suitable alternative check.

The second category includes offerings not firmly underwritten but containing implicit safeguards. They are exempt if purchased by certain kinds of investors under specified conditions: at least 25 percent must be purchased by "accredited" investors and all others buy on the same terms, and/or 25 percent of the outstanding shares must be owned by qualified venture capital companies throughout the life of the offering. This exemption is based on the assumption that accredited investors purchasing a significant percentage of an offering will have the leverage to ensure fairness and have a reasonable expectation of return. It also assumes that independent venture capitalists will have the leverage and expertise necessary to curb unfair or ill-structured offerings. The premise that the interests of public investors and venture capitalists will coincide in each case still has to be tested.

The third category includes securities of newly developing companies making an initial public offering with no established market value for these securities and essentially no earnings. These securities may be exempt from full review if three conditions are met: there must be evidence of "continuing commitment" of top management, namely, retention of at least 10 percent of the company's outstanding equity; no offering of nonvoting or inferior voting equity securities (except by registered brokers) is allowed; and a minimum initial offering price to the public of $5 per share is required.[117]

This option presumes that companies starting up need relief from the compliance costs they would incur during a full-scale merit review of their offerings. It is consistent with the present drive to reduce the regulatory burden on new and small businesses. Backers of this reform believe that the potential economic benefits of these new companies offset potential threats to investors, especially since top management must maintain a financial stake in the enterprise.

State officials expect these three merit review exemptions to cover most equity offerings. The new rule took effect on December 15, 1983. By the end of 1984, 125 new securities offerings had been registered using this new streamlined process, more than twice the previous annual average.[118] Venture capitalists and business associations have lauded the new requirements as instrumental in attracting new investments to Michigan. In its analysis of the new Michigan rule, the Securities Regulation Law Journal noted that it is "the most complex attempt to devise a set of merit safe harbors" for securities registration and that Michigan "should be credited for its willingness to consider new ways" to balance investor protection with regulatory requirements that could hinder capital formation.[119]

Reforming Franchise Law

Michigan's original franchise regulation statute was one of the first in the nation. Enacted in 1974, it was designed to protect residents from abusive or fraudulent business schemes. The law required franchisors to register with the Department of Commerce and obtain prior approval of advertising, franchise terms, and other arrangements. Its regulatory provisions were among the most stringent enacted by any state, however, and many reputable franchisors -- particularly smaller ones -- seemed to have decided that the regulatory burden of establishing a base in Michigan was not worth the expense and trouble.

As they grappled with the high unemployment of the last recession, state officials and trade groups realized that the establishment of more franchised businesses could create thousands of jobs in the state. They also recognized that what corporations viewed as unnecessary state interference in the name of protecting potential franchisees could be eliminated while retaining essential safeguards.

Representatives of the governor's office, the state legislature, the attorney general, and several business and consumer groups met in 1983 to develop franchise regulations that simplified the requirements for registration while maintaining necesssary franchisee protections. The legislation that evolved eliminated lengthy franchise registration requirements in favor of a simplified notice of intent to do business within the state and a filing of basic business information. The new p s provided consumer protection through franchisor disclosures and a strong state enforcement capability.[120]

The Franchise Investment Act provides a simple regulatory system with strong anti-fraud protections. It is designed to minimize the involvement of state agencies and reduce the time and cost of franchising in the state. The legislation was supported by groups as diverse as the Michigan State Chamber of Commerce and the Michigan Consumers Council.[121] The new law took effect in mid-June, 1984; in the first six weeks 64 new franchise operations registered (compared to the average two or three a week under the old statute).[122]

Franchise activity throughout 1984 was higher than in previous years. State officials and business groups credit it with bringing new business operations and jobs to the state.

Overhauling Workers' Compensation

Workers' compensation has been the subject of considerable debate in Michigan for many years. The system provokes the most frequent complaints of Michigan business owners, particularly those operating small businesses.[123] Its costs are higher consistently than those in most neighboring industrial states. Many business associations also view the workers' compensation insurance system as a distinct deterrent to economic expansion and business location within the state.

From 1958 to 1965, Michigan employers spent less on workers' compensation insurance than the national average. However, costs escalated rapidly from 1965 to 1978, when they reached 33.1 percent more than the national average. From 1962 to 1984, Michigan employers paid workers' compensation costs exceeding the average of the other Great Lakes states as well. This adverse differential peaked in 1978, when Michigan employers spent 48.2 percent more than their Great Lakes states counterparts. The extent of this cost disadvantage has narrowed, but it still remains 31.2 percent higher.[124]

State government and the private sector have debated this issue for the past three decades. It has been the subject of three extensive studies since the early 1960s, parts of which were incorporated into major reform measures enacted in 1980 and 1981.

Recent Statutory Changes

Concerned that rapidly escalating costs would hinder business growth within the state, the legislature and the Milliken administration devised a package of 12 amendments to the existing workers' compensation law that were enacted in 1980 and 1981. The most important change required the coordination of workers' compensation benefits with unemployment plans, disability insurance, and employers' contributions to Social Security. Minimum benefits were eliminated and some categories of disability were defined in statute.[125] Related legislation enacted in 1981 changed prevailing insurance practice: the legislature required a 20 percent roll-back in insurance rates, effective January 1, 1982, and stipulated that open competition for insurance underwriting would begin on January 1, 1983.

Most of these changes took effect between January and March 1982. The statutes allowed increased worker benefits but they also instituted new mechanisms to reduce questionable claims and open competition in rates. These reforms have saved employers considerable amounts. As with all insurance systems, the fewer the claims requiring compensation, the lower the cost of providing the insurance. Eliminating a uniform state rate structure for all carriers has permitted employers to comparison shop for insurance plans tailored to their needs. It also has forced insurance providers to compete, and some have lowered their rates below the statutory ceiling to do so. Total claims have declined more than 40 percent since 1981, and contested claims are down more than 50 percent. Average employer payouts have dropped by about 6.2 percent, even though maximum weekly benefits for most disabled workers have

increased substantially (see Figure 7).[126] Michigan employers paid $533 million for workers' compensation premiums in 1983, the first year of open competition, and about $493 million in 1984. According to the report Workers' Compensation in Michigan: Costs, Benefits and Fairness, issued to the cabinet council in December 1984, these amounts were 30 percent less than expected in the absence of open competition. Employers saved $229 million in 1983 and $212 million in 1984.[127]

Proposed Efforts

Nevertheless, controversy over the system has persisted, fueled by increasing numbers of claims during the 1982 recession, continuing high levels of redemptions and contested cases, and a huge backlog of unresolved claims. In an effort to deal with this on-going problem, Governor Blanchard appointed University of Michigan Law School professor and former dean Theodore St. Antoine as Special Counselor on Workers' Compensation in September 1983. St. Antoine was directed to review Michigan's current system for its effectiveness and identify areas of abuse or inefficiency adding unnecessary costs. Blanchard set the context for the review by stating that "the employee who is the victim of industrial accident or disease is entitled to prompt, reasonable compensation. The employer who must pay should be burdened with no more than fair and appropriate costs."[128]

In his analysis, St. Antoine concluded that much had been accomplished, especially for the business community, but in certain important respects for the workers as well.[129] However, the report found that the full impact of the 1980 and 1981 legislative reforms had not been realized. For instance, it questioned whether enough time has passed since the start of open competition to consider insurance rates stabilized. Business leaders argue that rates might have dropped artificially during the first phase of insurance business competition. St. Antoine emphasized that more time would be needed to assess the modified legislation completely. He considered it premature to consider further major substantive revisions in the statute at that time.

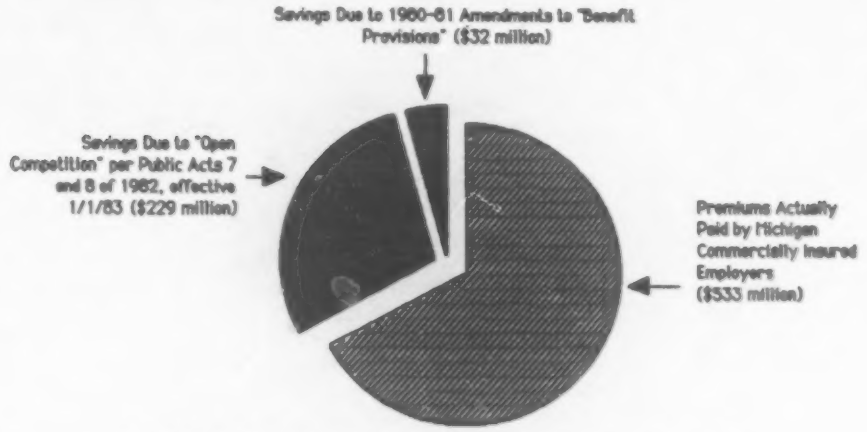
The report made several important recommendations for changes in program administration, including:

- placing increased emphasis on medical and vocational rehabilitation to get injured workers back on the job;
- adopting new measures to contain medical costs;
- automating bureau administration;
- establishing a permanent workers' compensation labor-management advisory council to oversee the system and to prevent a crisis atmosphere from occurring when changes are considered; and
- revising procedures to eliminate the five-year, 7,000 case backlog.[130]

FIGURE 7

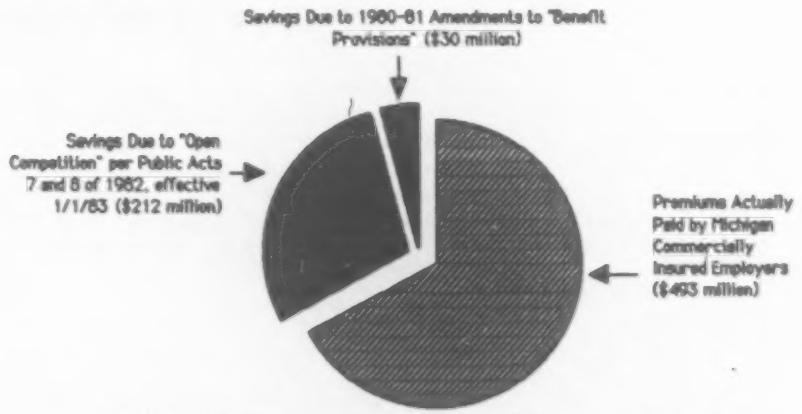
Workers' Compensation Costs

1983 Projected and Actual Premiums and Savings


Savings Due to 1980-81 Amendments to "Benefit Provisions" ($32 million)
Savings Due to "Open Competition" per Public Acts 7 and 8 of 1982, effective 1/1/83 ($229 million)
Premiums Actually Paid by Michigan Commercially Insured Employers ($533 million)

Total Projected Premiums Without Recent Changes	$794 million
Actual Premiums Paid	- $533 million
TOTAL SAVINGS	$261 million

1984 Projected and Actual Premiums and Savings


Savings Due to 1980-81 Amendments to "Benefit Provisions" ($30 million)
Savings Due to "Open Competition" per Public Acts 7 and 8 of 1982, effective 1/1/83 ($212 million)
Premiums Actually Paid by Michigan Commercially Insured Employers ($493 million)

Total Projected Premiums Without Recent Changes	$735 million
Actual Premiums Paid	- $493 million
TOTAL SAVINGS	$242 million

SOURCE: Theodore J. St. Antoine, Workers' Compensation in Michigan: Costs, Benefits, and Fairness (Ann Arbor, Michigan: University of Michigan Law School, December 1984), p. 18 following.

The report discussed the case backlog at some length. It recommended the elimination of the present two-tiered structure for decision-making in contested cases. Now, decisions of administrative law judges -- the first layer -- are fully reviewed and essentially retried by the appeal board. St. Antoine suggested that the judges prepare written opinions and findings of fact, and that the appeal board focus its assessment on errors of law and procedural mistakes. This process would eliminate a time-consuming second assessment of every case. He further recommended more professional scrutiny to strengthen the administrative law judge system. These recommendations have been submitted to the cabinet council, which intends to examine workers' compensation issues during 1985. The state legislature also began considering alternatives.

The Michigan Manufacturers Association and other business groups still view workers' compensation costs as too high, even though they have fallen. These groups insist that "the program is perceived and is, in fact, a costly disincentive for doing business" in Michigan.[131] They disagree with the St. Antoine premise that more time is needed with the existing conditions before considering further changes. For example, approximately 40 percent of the businesses covered under self-insured plans report that they see little benefit in the new system except for coordination with retiree benefits.[132] In 1985, the association will push for additional refinements in the definition of disability. They are likely to find a receptive audience in the legislature. While they differ on means, these groups recognize that state government shares their general goal of improving the workers' compensation system so that it does not hinder business investment.

Refining the Single Business Tax

The Michigan Single Business Tax (SBT), was adopted in 1975, replaced a state corporate income tax and six other business taxes. Its basic provisions have been modified several times in the past decade; even now, revisions to further stimulate new business investment are under consideration.

The SBT is a modified value-added tax: each firm is taxed on the value it adds to the materials and services purchased from other firms. Only the addition -- the value added to those materials by the productive process -- is taxed. This differs from a traditional profits-based tax, in which business activity is assessed on net company profits. The SBT could be considered a charge levied on businesses for government services rendered, not a form of national sales tax like European VATs. Michigan is the only jurisdiction in the United States to use any form of a value-added tax.

In its January 1985 Analysis of the Michigan Single Business Tax, the Department of Treasury cited three advantages of a value-added tax over a conventional corporate income tax:

- more revenue stability, especially given the cyclical nature of the Michigan economy;
- greater incentives for new investment, since capital expenditures are fully deductible in the year they occur, rather than depreciable over time; and

- broadened business tax coverage and increased fairness, since it applies to all business activities regardless of form.[133]

State treasury officials view the SBT as having a "small but significantly positive impact" on the state's business climate.[134] Small and start-up firms have found its structure and provisions more helpful than a conventional profits-based tax. Some growing companies also find it a beneficial tax system -- an advantage cited in a recent Purdue University study which recommended that Indiana adopt a SBT-type system to aid expanding businesses.[135]

Shaping the SBT

When the legislature passed the measure in 1975, it adopted special preferences to exempt businesses that would have paid much higher taxes under the SBT system: unincorporated firms (the SBT applied to them while the repealed corporate income tax did not); and firms with a high ratio of value added to profits or payroll, such as construction companies or durable goods manufacturers.

In the SBT's first year in effect, companies incurring increased tax liabilities continued to press for further concessions. Since 1977, the legislature has adopted various amendments to deal with these requests. The recent Treasury Department report examined SBT adjustments; the most important now in place are described below.

- Businesses may deduct the full value of capital acquisitions in the year they are made. This provision is designed to encourage business-modernization investments.

- Firms with negative adjusted tax bases (usually because of such capital deductions), may carry those negative amounts forward over the next ten years. The service sector claims over one-third of this adjustment, which tends to benefit smaller firms.

- Small businesses get a significant break from a statutory exemption of $40,000; increased exemptions (to a total maximum of $48,000) are permitted for partnerships or professional corporations with additional shareholders or partners. The statutory exemption offsets over half the tax base for companies in the lowest brackets required to file. Moreover, the exemption's impact on the smallest firms is substantial. Those with gross receipts of less than $40,000 are not even required to file SBT returns because the exemption would eliminate their tax liability.

- If total payroll is more than 63 percent of its tax base, a business may reduce that base by the amount of employee compensation exceeding 63 percent. This adjustment is used most often by companies with an adjusted tax base of at least $500,000. The auto industry is the greatest beneficiary of this provision, claiming 27 percent of total excess compensation reductions in 1981.

- Firms may use a gross receipts reduction to decrease their tax base by the amount that the base exceeds 50 percent of their gross receipts. The service sector, which tallied 10 percent of this reduction, was the largest beneficiary.

- Small business credits now are available to firms with gross receipts of $6 million or less, adjusted business income of $45,000 or less, and no more than $90,000 earmarked for shareholder or officer income. These credits, which were raised in 1984, permit eligible businesses to receive a tax credit based on the ratio of adjusted business income to 45 percent of the SBT base, up to a maximum of 90 percent.[136]

In general, the statutory exemption and capital acquisition deductions are the most important adjustment used by small businesses. Medium-sized companies usually have their taxes reduced by claiming capital acquisition deductions, excess compensation reductions, and small business credits. The largest firms benefit most from the capital deduction and the excess compensation reduction.

Operation of the SBT

The SBT has provided about 15 percent of Michigan's tax revenue since 1982. Employee compensation constitutes 77 percent of the state's tax base (value-added), consistent with national figures showing that labor income comprises 70 percent of total U.S. income.[137] Within Michigan, manufacturing constitutes 44 percent of value-added receipts among taxable companies, more than twice as much as any other individual business sector.

However, more than 127,000 businesses -- about 60 percent of Michigan's total -- paid no SBT in 1981. Three-quarters of all companies had an SBT liability of less than $1,000 and contributed less than 2 percent of total SBT revenues. Only 62 firms had SBT liability exceeding $1 million that year; these companies (0.03 percent of the state's total) accounted for 29 percent of all taxes paid. Table 9 documents SBT liability by classification. These tax base adjustments and SBT credits reduced tax liability for many firms. The extent to which the 214,000 firms filing SBT returns in 1981 used them is illustrated in Table 10.

Recent and Proposed SBT Changes

The most significant recent change is the small business credit. Beginning in 1984, the revised credit increased the number of businesses that meet basic eligibility requirements. It also increased the maximum amount of the credit to 90 percent of the firm's tax liability. According to state estimates, an additional 3,500 small companies are eligible for the credit.[138]

The value-added structure of the SBT provides an interesting contrast to other state tax systems. Michigan officials would like to improve SBT's effectiveness further and complement other state initiatives such as technology development. To this end, the Treasury Department is contemplating recommendations for further changes in the SBT, such as expanding a research and development credit and removing some or all of workers' compensation and unemployment compensation costs from the tax base. The governor has requested a report on several tax issues including the SBT which will identify loopholes and recommend ways to remove state tax code inequities. This study will be completed in 1985.[139]

TABLE 9

SBT Liability by Classification-Size,
1980-81 Tax Year

Tax Liability Class	Number of Businesses	Percent of Businesses	Cumulative Percent of Businesses	Amount of Tax Paid (thousands of dollars)	Percent of Tax Paid	Cumulative Percent of Tax
Did Not File (No Liability)	52,500	24.5	24.5	0	0.0	0.0
Filed Short Form (No Liability)	31,293	14.6	39.1	0	0.0	0.2
Filed Completed Form (No Liability)	43,603	20.4	59.5	0	0.0	0.0
0- 100	6,369	3.0	62.5	310	*	*
100- 1,000	29,271	13.7	76.2	13,858	1.6	1.6
1,000- 5,000	32,669	15.3	91.5	77,047	8.9	10.5
5,000- 10,000	7,895	3.7	95.2	55,396	6.4	16.9
10,000- 50,000	8,341	3.9	99.1	173,757	20.2	37.1
50,000- 100,000	1,130	0.5	99.6	78,659	9.1	46.2
100,000- 500,000	805	0.4	99.8	160,585	18.6	64.8
500,000-1,000,000	71	*	99.9	49,608	5.8	70.6
1,000,000 and Over	62	*	100.0	252,892	29.3	100.0
TOTAL	214,000	100.0	100.0	862,112	100.0	100.0

*Less than 1 percent.

SOURCE: Michigan Department of Treasury, Taxation and Economic Policy Office, cited in Analysis of the Michigan Single Business Tax (Lansing, Michigan, 1985), p. 45.

TABLE 10

SBT Adjustments, 1981

Feature	Number of Businesses	Percent of Businesses[1]	Tax Reductions (in millions of dollars)
Capital Acquisition Deduction	79,019	60.7	312.0
Statutory Exemption	64,636	49.6	47.0[2]
Business Loss Deduction	9,702	7.5	29.5
Labor Intenstity Reduction	45,810	35.2	162.7
Gross Receipts Reduction	12,153	9.3	39.9
Small Business Credit	30,464	23.4	25.6
Unincorporated Business Credit	33,727	25.9	7.4
Contribution Credit	3,333	2.6	1.9

[1]Percent of all businesses filing full SBT returns, including those with zero tax liability.

[2]Minimum; does not include businesses with gross receipts under $40,000, which are not required to file.

SOURCE: Department of Treasury, Analysis of the Michigan Single Business Tax (Lansing, Michigan, 1985), p. 34.

VII. Cooperative Programs for Development and Training

Although job-creation and job-training programs traditionally have operated independently, both are part of the same economic development strategy. Public and private roles in the development and job-generation process have changed significantly in the last dozen years; formerly separate activities often have evolved into partnerships. This phenomenon has made state and local development efforts much more complicated, but it also has created new opportunities to tie economic development and job opportunities together. The public and private sectors now must respond to new, often unexpected, and substantially different demands for job skills, types of financing, and services necessary to support investment.

A healthy environment for economic development depends on the availability of a suitably trained work force. Likewise, successful training programs need a steady source of new jobs for their graduates, since training without employment serves no purpose. One of the most important challenges facing agencies promoting development and those sponsoring training is establishing effective ties between their goals and activities. These ties are beginning to emerge slowly. The full partnership between job generators and job trainers envisioned by the Job Training Partnership Act (JTPA) of 1983 has yet to materialize, although some jurisdictions have made progress toward this goal. A few community organizations have set up their own businesses to employ disadvantaged local residents directly. Others operate as job developers or brokers, encouraging new and growing companies to hire graduates of local training programs.

Michigan is home to at least three innovative models of economic development-employment and training alliances. Two, Downriver Community Conference and Focus:HOPE, have done exemplary work in providing training services and economic development assistance. The third is an experiment in cooperation among these organizations and a venture capital firm.

Downriver Community Conference

Downriver Community Conference (DCC) is a community-based consortium of 16 southern Wayne County communities that "provide more efficient, effective, and comprehensive government services."[140] DCC served as a prime sponsor under the Comprehensive Employment and Training Act and is now a JTPA service-delivery administrator. DCC has broad legal authority to administer programs and

deliver services, but is not authorized to issue bonds or levy taxes. Most of DCC's funding comes from state and federal assistance and foundation grants; member communities provide the balance.

Many communities have developed effective training programs; DCC, however, has gained national acclaim with its wide array of services and comprehensive approach to combining economic development and training. It provides the traditional job-training and employee-screening functions plus more aggressive job-generating activities such as business loan packaging, procurement assistance, and incubation space. Unlike their counterparts in typical job-training or development agencies, DCC officials strive to convince other agencies and employers that economic development and job creation are interrelated, and urge both to recognize this relationship and factor it into their programs or operational design.

Participating companies believe that DCC's success comes from "playing to its audience."[141] Conference programs emphasize services to employers, particularly to stable or expanding businesses likely to hire new people. DCC also is one of the few training-program operators in the country to pursue job generation aggressively: its development professionals have devised several business assistance programs with this goal. For example, its federal procurement effort is targeted to small manufacturing companies operating at less than 75 percent of capacity. Although the firms are expected to write the bidding proposals, DCC staff review the necessary paperwork and tracks it through the bidding process. To date, these efforts have resulted in $61 million in contracts that are credited with creating or retaining hundreds of jobs in the Downriver area.[142]

As the area's designated JTPA program administrator, DCC runs several training programs for structurally unemployed adults and disadvantaged youth. These activities, including standard services such as customized and on-the-job training, applicant prescreening, and targeted jobs tax credit assistance, are largely the province of the conference's employment and training department.

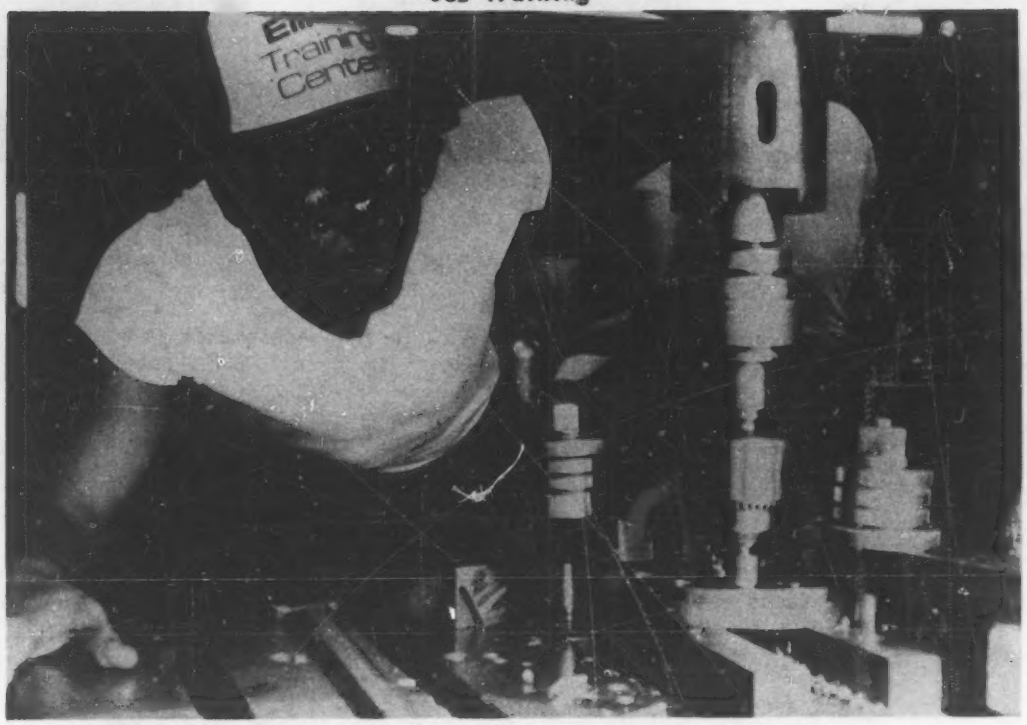
DCC operates several economic development programs to complement its training efforts. Staff members identify prospective employers, help analyze their needs, and marshal Downriver resources to help resolve business and employment problems. Local employers can participate in the program in three ways:

- o identifying occupations with future employment needs that unemployed workers can be trained to fill;
- o overseeing the development of job services in conjunction with DCC staff; and
- o assessing the effectiveness of training resources, curricula, and facilities by serving on an employer review board.[143]

Downriver's economic development department has three operating divisions: government marketing, industrial development, and small business assistance. It also runs a Business Venture Center and Small Business Assistance Center. Working with job developers and with the local Private Industry Council, department staff have made substantial progress in linking training and development, an approach paying handsome dividends in job placements.

FIGURE 8

Job Training



Michigan has produced several pioneering job-training programs that are closely linked with economic development efforts.

SOURCE: National Alliance of Business

Government Marketing Division. This division helps clients in selling goods and services to government agencies. Government purchases can be a major source of revenue to communities. The division has run a series of procurement seminars for area businesses and published a detailed guide, Marketing to the Government. It also helps companies with bid preparation. Recently, the division expanded its outreach efforts by organizing an 11-firm "trade mission" that called on major defense contractors. This trip received favorable reviews from contractors and generated business opportunities for participating small companies.

Since its establishment in 1982, the division has assisted 127 firms to obtain over $61 million in government contracts.[144] It plans to computerize its list of client firm capabilities, which will give companies easier and faster notification of bid opportunities.

Industrial Development Division. This division is structured to promote business development and attract new companies. One of its major functions is collecting, assessing, and publicizing community profiles and related data, an unusual activity for this type of agency. In 1984, this information was used

in 16 site searches for companies wishing to locate or expand in the Downriver area. Working with the state department of commerce and local economic development experts, the division recently conducted several business-retention visits; it also identified six business-expansion possibilities and 13 companies offering job and training opportunities.[145]

Downriver recently received $758,000 from the federal Economic Development Administration to expand its business incubator and implement a small business revolving loan fund. Finance assistance is available through the fund to both industrial and service companies in the Downriver area, according to the following conditions:

- Businesses must obtain private-lender financing at a ratio of $2 to every fund dollar.
- A minimum of one job to every $5,000 in fund assistance is required, and projects with the highest level of job creation and retention will receive priority.
- Companies must agree to a two-year "first source" agreement with DCC, considering its employee referrals for positions before others.[146]

The division plans to improve Downriver's ability to undertake site searches for companies interested in moving to the area by developing a computerized site and facility file connected with the state Department of Commerce. The department maintains extensive information on assistance programs and training services available to businesses. This link will allow DCC to make a more aggresive marketing "pitch" because its information will be more complete.

Small Business Assistance Division. This division provides specific services to small businesses in coordination with the other two divisions. Most relate to business finance -- advice on securing lines of credit, serving as liaison with lenders, and so forth. Depending on the perceived return to the Downriver communities (in the form of new jobs, relationship to area economic development strategies, spin-off opportunities) staff may assist small organizations with business plans, financial analyses, and site selections.[147] For example, the division devoted considerable effort in 1984 to helping automotive-related companies and machine shops obtain financing for new equipment and plant modernization.

Department-wide Activities. The economic development department as a whole also works with various communities within the Downriver area on specific projects with job creation and retention potential. The biggest is Heritage Center, a 500-acre industrial development in the heart of the Downriver community. Planners chose a site on an expressway corridor for visibility, ease of access, and, more importantly, for its potential as a major focus for business development in the area. Community officials hope that such a concentration will attract even more new companies, especially high-growth enterprises.

Two new facilities are planned. The first would house a sheet-molding compounds operation run by the major local manufacturer providing much of the construction funding. The second would contain a privately owned business incubator facility similar to DCC's Business Venture Center. It would have space for half a dozen companies specializing in high-technology products and services related to the automotive speciality market. Emerging companies would

FIGURE 9

DCC Promotional Brochure

Through its outreach efforts, DDC publicizes its diverse economic development and training abilities.

receive financial assistance from the same manufacturers during their initial stages. For that help, the companies would agree to some type of payback once the product or service reached the manufacturing or marketing stage.

The department has undertaken other development-training projects. These include:

- Identifying and developing job-development strategies to improve the competitive position of several Urban Development Action Grant applications.
- Concluding negotiations with SBA to include the DCC Business Center programs in the national Small Business Development Center (SBDC) network.
- Attracting state funds to conduct its third annual Entrepreneurial Forum in conjunction with the Greater Detroit Chamber of Commerce.

DCC helped package nearly $1.5 million in business financing through its Small Business Assistance Center in its most recent fiscal year. Two-thirds of the assisted firms were local, others were located in Detroit and elsewhere in Wayne County.[148] Table 11 shows highlights of DCC's recent economic development activities.

TABLE 11

Summary of DCC Economic Development Department: Fiscal 1983-1984

	Downriver Area	Other Areas	Total
Firms Served			
Government marketing	57	245	302
Industrial development	8	4	12
Small business assistance	127	92	219
Selected Activities			
Persons employed	105	28	133
Business forum attendees	53	5	58
Venture center tenants	5	2	7
Retention visits	6	-	6
Business starts	9	2	11
Business expansions	3	4	7

SOURCE: Downriver Community Conference, FY1983-1984 Annual Report (Southgate, Michigan, 1984), p. 23.

DCC intends to create several investment vehicles to recycle and leverage public resources for economic development. One proposal under consideration would establish a "community reinvestment bank" to collect and manage repayments from any multi-community federal Urban Development Action Grant. The conference also has completed the first phase of an extensive planning and marketing study for the Downriver area to help define types and locations of development concentration.

Focus:HOPE

Focus:HOPE, a civil and human rights organization serving metropolitan Detroit, develops businesses and trains workers at its "Industry Mall" located in a distressed Detroit neighborhood suffering from high unemployment. By all accounts, it has brought a successful blend of entrepreneurship and public-private-partnership to the training environment. This cluster of once-abandoned factory buildings houses several manufacturing facilities, a print shop, and a training program for machinists.

Focus:HOPE officials chose machinists for practical reasons. Michigan is a national center for precision machining and tool and die industries, accounting for over 20 percent of national production.[149] The demand for skilled machinists in southeastern Michigan is especially great. The federal Bureau of Labor Statistics estimates that at current employment levels, a national shortage of machinists will occur by 1990.[150]

The JTPA-assisted Machinist Training Institute provides both basic and

advanced training for disadvantaged and minority Detroit residents interested in a machine tool career. Focus:HOPE promotes its program as "the country's largest, best-equipped school for machinists, containing nearly 200 machine tools."[151] It offers an eight-month basic course and advanced training in subjects such as computer numerical control. Instructors are primarily retirees with many years of experience. An important feature of their training course is actual contract production, which gives students experience with industry performance standards.

The Machinist Training Institute has had a good completion and placement record. Since the program began, two-thirds of its enrollees have graduated from its very rigorous course, and 92 percent of them have obtained jobs -- 68 percent in the machine tool or related industries. In its three years of operation, the Institute has graduated over 200 students and placed them with more than 50 companies, as shown in Table 12.

Industry Mall also provides space for Cycle-Tec Industries, a small business that remanufactures General Motors transmissions that have broken down under warranty. Focus:HOPE bought Cycle-Tec in 1984 when the company was on the brink of dissolution. At the same time, it was able to win a warranty-replacement contract with General Motors for its newest models. Since then, employment in the firm has risen from 35 to 78 hourly workers. By January 1985, it had over 15,000 transmission orders pending for $3 million worth of work.[152]

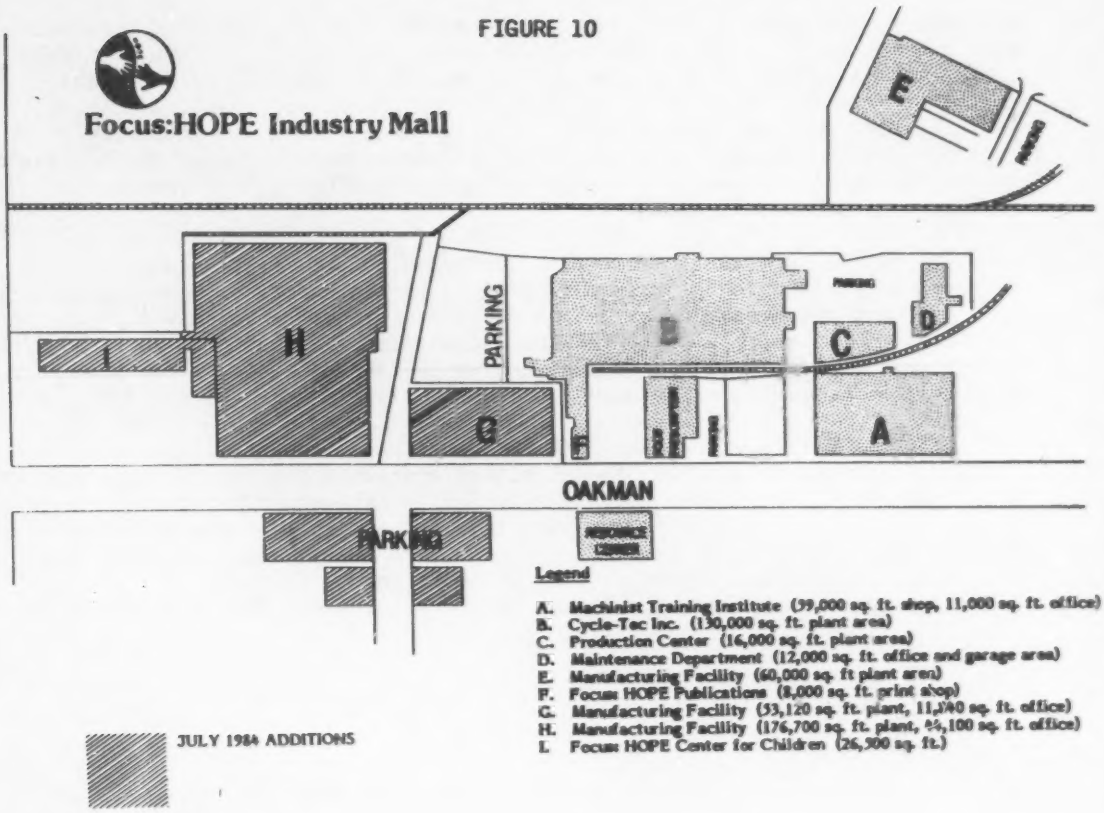
TABLE 12

Machinist Training Institute Graduates and Placement

	Number Enrolled	Number Graduated	Number Currently Enrolled	Related Placements	Non-Related Placements
Class 1	55	44	0	34	9
Class 2	22	12	0	8	5
Class 3	26	23	0	8	5
Class 4	35	19	0	12	8
Class 5	53	29	0	15	16
Class 6	49	37	0	34	1
Class 7	49	25	1	17	2
Class 7.5	21	16	0	10	2
Total	310	206	0	140	50

SOURCE: Focus:HOPE, unpublished program data, January 22, 1985.

FIGURE 10


Focus:HOPE Industry Mall
E
H
I
PARKING
B
C
D
G
A
OAKMAN
PARKING
Legend
A. Machinist Training Institute (39,000 sq. ft. shop, 11,000 sq. ft. office)
B. Cycle-Tec Inc. (130,000 sq. ft. plant area)
C. Production Center (16,000 sq. ft. plant area)
D. Maintenance Department (12,000 sq. ft. office and garage area)
E. Manufacturing Facility (60,000 sq. ft plant area)
F. Focus: HOPE Publications (8,000 sq. ft. print shop)
G. Manufacturing Facility (53,120 sq. ft. plant, 11,140 sq. ft. office)
H. Manufacturing Facility (176,700 sq. ft. plant, 44,100 sq. ft. office)
I. Focus: HOPE Center for Children (26,500 sq. ft.)
JULY 1984 ADDITIONS

SOURCE: Focus:HOPE.

Focus:HOPE plans eventually to convert Cycle-Tec into a minority-owned business and is developing a management team to run it. In late 1985, employees will be given the option to buy stock in the firm. Future development plans include the establishment of several more minority-owned machine shops in Industry Mall.

Venture Capital and Training: A New Model

Successful combinations of job-creation and training programs require participation by both public and private-sector organizations. However, mainstream business developers and financiers rarely are part of job-generating and training partnerships. In Michigan, however, a special collaborative project joins three of Michigan's premier economic development and job-training organizations -- Downriver Community Conference, Focus:HOPE, and Detroit's SER Jobs-for-Progress -- with the Michigan Investment Fund (MIF), a private venture capital fund.

The goal of the project is to improve the economic fortunes of one of Michigan's most depressed areas, metropolitan Detroit, by encouraging greater private investment and stimulating business growth and higher employment. The area has suffered numerous plant closings and job losses over the past several years. Project organizers believed that economic revitalization in southeastern Michigan would be enhanced by linking the job-creation capabilities of MIF with the job-training capabilities of the other three organizations.

The project is carefully structured to create formal ties among the participating groups -- ones that would not have begun in the normal course of operation. The consortium's project team prepared a joint business plan establishing specific goals and a timetable for their completion; it also arranged for an outside evaluation of the project's success.

In 1983, the Ford Foundation awarded a $2 million, seven-year loan and an accompanying $103,500 administrative grant to get the project started. On behalf of the consortium, DCC invested the $2 million in MIF, making DCC a limited partner in the fund. Ultimately, these endeavors will help determine the extent to which the business finance and employment and training communities can cooperate effectively and whether joint effort accomplishes more than individual attempts.

The loan terms define an elaborate set of arrangements between MIF and the three training organizations. MIF runs a branch office, staffed by a professional venture capital investment analyst, at DCC's headquarters in Southgate. A specifically assigned DCC job developer pursues job leads generated by the MIF participation. The fund provides regular reports to DCC on all businesses under consideration as investees. The heads of all four organizations meet quarterly to review their joint progress and resolve any problems.

These arrangements are intended to encourage a free flow of information among the four organizations. Possibly the greatest potential advantage of this collaboration is each organization's access to information or services which could be of great value from one or more of the other project partners. MIF occupies the central role in this exchange. In the on-going search for investment opportunities, MIF staff are constantly identifying new and growing businesses with employment needs. Although only a fraction of these businesses will eventually become part of MIF's investment portfolio, many of them harbor promising leads for the training programs. The project also ties into the practice of venture capitalists to act as general advisor to their portfolio companies. As part of its counseling with clients, MIF has agreed to promote the job services of DCC, Focus:HOPE, and SER and to encourage the hiring of disadvantaged workers.

Some of MIF's referrals are directed to DCC's business assistance center rather than to the jobs program. The fund encounters numerous small companies which, although they may not make it into the MIF portfolio, have strong job-creation potential. DCC's business and economic development staff can provide a range of services to strengthen these companies and keep them in the area. To improve DCC's response, the project agreement requires MIF to help train DCC staff in the venture capital process. DCC and Focus:HOPE, in turn, draw upon knowledge of their respective communities to steer MIF toward high-potential local companies that otherwise might not be identified. More importantly, they offer MIF an impressive package of employment services that can further improve the profitability of applicant firms. They include recruitment, counseling,

testing, and screening of applicants, and a range of different training options, including on-the-job, customized, and classroom training.

Although it is too early to judge its success, the consortium's business plan sets forth an ambitious set of goals for investment and new job placement. Over the seven-year term of the project, MIF is expected to direct $2 million in venture capital to firms within an hour's drive of the consortium's clients. MIF is investing mostly in emerging high-growth, noncyclical companies in fields such as biomedical products, computer hardware, and industrial automation in which new job creation and new economic activity are expected to provide the greatest per-dollar return.[154] Historically, the Wayne County-Downriver area has been a center for heavy manufacturing, particularly steel and autos. Although these industries have experienced permanent downturns, many auto supplier companies and related businesses in these communities have thrived.

MIF also aims at industrial diversification and innovative technology investments. Thus, it complements the state's economic advantage in its own way. The project's sponsors project it will create 2,350 new jobs in seven years, including 750 placements by the participating organizations. DCC, Focus:HOPE, and SER will divide these placements on a 50-25-25 percent basis.

The business plan emphasizes that the impact of project-inspired new investment and jobs may exceed these estimates. The $2 million in venture capital, for example, may leverage as much as $12 for every MIF dollar in terms of additional equity and debt. Likewise, each primary job created under the project can generate two or three secondary jobs.[155] Any profits remaining after the three organizations repay the Ford Foundation loan will also be distributed among them on a 50-25-25 percent basis. DCC will use its portion to create a loan pool to assist small, labor-intensive businesses.

It is too early to measure the project's success against the benchmarks in the business plan. Actual job placements during the first year fell far short of the target. However, project personnel shifts and other factors contributing to a slow start-up make these early data inconclusive. Investment goals for the first year have been exceeded, and project officials anticipate additional job opportunities, although they are yet unrealized.

Though its success is not yet assured, the DCC-MIF partnership is one of the most innovative models of economic development combined with employment and training programs in the nation. It combines support from the philanthropic community with enormous committed resources from both the nonprofit sector and a for-profit venture capital investment firm. Its progress and eventual results will provide a more solid base of knowledge about the practical relationships between economic investment and employment. It might reveal the extent to which cooperative agreements between venture capitalists and quasi-public development and training service providers realistically can work cooperatively to foster job development and training opportunities. The outcome will provide a good indication as to whether venture capital resources can be directed to job-creating investments in distressed areas. It could show if cooperative relationships established under the project can continue after the initial term expires, and .pa whether the private, philanthropic sector can play a significant role in developing and sustaining these linkages.

This latter issue will be particularly important, since many of the nation's foundations are beginning to explore development investment as a way to leverage their contributions. Through this project, the Ford Foundation has taken the lead in supporting innovative development and training models. The Charles Stewart Mott Foundation, among others, also is playing an important role in Michigan's small business development by investing $4 million and serving as a limited partner in MIF.

DCC has put to the test the increasingly popular conception that economic development and training links will generate increased levels of private investment and job creation. Several Michigan organizations, in structuring these partnerships, have developed important ties that have proven useful in conjunction with the state's economic revitalization strategy. They have created a climate in which training is viewed as an important economic incentive, along with more traditional capital and financing tools. If DCC is successful in meeting its ambitious long-term business plan could provide a replicable model that would alter the way state and local officials marshal resources to spur local job-creation efforts.

VIII. Conclusion

Michigan seems to have created a forward-looking development strategy that will give it economic strength during further downturns. Officials from all sectors have recognized that manufacturing is the basis of the state's economic advantage. It remains the foundation of the state economy, and the state remains a world leader in durable goods production. Michigan has acknowledged the role of high technology in economic diversification, but has not neglected everything else in its pursuit. Manufacturing has undergone great changes recently. State leaders recognize that "a premature funeral has been held for American manufacturing."

Two key elements to moderating cyclical swings, which will continue to plague the state's future, are an improvement in the competitive position of its base industries and the promotion of growth through technological advancement. The state has assumed the needed role of catalyst and investor. State officials conducted a thorough analysis of the state's economy and all existing and planned reform efforts. Based on this analysis, they have developed solid, practical economic development strategies and a series of steps to implement them. As identified in this report, state government has defined its role to include the following:

- Assisting the private sector through economic transition. The state is modernizing its administrative and financial procedures to help business regain a competitive edge.

- Emphasizing a target industry program to identify and then exploit the state's development opportunities in several sectors. Through selective use of resources, the state can help influence the private marketplace and respond to special needs and opportunities of existing and potential industries.

- Investing in applied research with future commercial applicability;

- Lowering the aggregate cost of doing business in Michigan by reducing tax and regulatory burdens, and improving the state's overall business climate;

- Providing investment funds to new and expanding businesses, joining with private venture capital institutions when possible; and

- Developing a coordinated public-private investment strategy for both worker training and development, thus giving them the skills necessary for the new technologies.

Michigan must plan carefully to ensure that the many successful new initiatives, such as the ombudsman office and regulatory review procedures, are institutionalized within the state government. They must continue once the initial enthusiasm fades. Reforms built on the presence of one administration or department head are frail; they must attract and maintain strong bipartisan support. Additional suggestions for state officials to consider include:

- Increased outreach efforts to make sure that smaller cities and businesses are fully aware of recent regulatory changes and new opportunities for financial and technical assistance now provided by the state. Michigan's first round of advertising and personal plugs has contributed to the turnaround in perceived business climate; these efforts should be continued in a second round targeted to smaller cities and businesses.

- Creative job-development and training alliances such as those put into place by Downriver Community Conference should be replicated around the state. The centers for excellence and state venture capital activities have the potential to generate many new opportunities for effective ties and job creation; these should be explored.

- Building on the St. Antoine report findings, additional workers' compensation adjustments should be structured to correct remaining inequities, especially those facing new businesses.

"Economic development" is a continuing process. If a strategy -- no matter how channeled or how sweeping -- is to succeed, it must have a base in an economy already providing some form of employment and investment opportunities. The task is not to start over again, but rather to build on and improve the existing economic base. Michigan officials have made a promising start.

Footnotes

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